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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 710

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR

TRANSCRIPT OF RECORD

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 29, 1944
CERTIORARI GRANTED JANUARY 8, 1945

SUPREME COURT OF THE UNITED STATES

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1 In the Tax Court of the United States

Docket No. 107302

TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR OF THE LAST WILL AND TESTAMENT OF EDWARD T. BEDFORD,

v.

COMMISSIONER OF INTERNAL REVENUE

Amended Title Estate of Edward T. Bedford, Title Guarantee and Trust Co., Executor. See Order of 6-3-41.

Docket entries

Appearances: For Taxp'r: HOLT S. MCKINNEY, Esq. Fof Comm'r: H. C. CLARK, Esq.

1941

May 14—Petition received and filed. Taxpayer notified. Fee paid.
May 14—Copy of petition served on General Counsel.
May 31—Motion to amend the caption filed by taxpayer.
June 3—Order amending caption to read Estate of Edward T. Bedford, Title Guarantee and Trust Company, Executor entered.
June 17—Answer filed by General Counsel.
June 17—Request for hearing in New York City, filed by General Counsel.
2 June 19—Notice issued placing proceeding on New York, N. Y. Calendar. Service of answer and request made.

1942

Apr. 15—Hearing set May 25, 1942 in New York City.
May 28—Hearing had before Mr. Arundell, on the merits. Submitted. Stipulation of facts filed. Petitioner's brief due July 15, 1942. Respondent's due August 15, 1942. Reply, August 27, 1942.
June 9—Transcript of hearing 5-28-42 filed.
July 15—Brief filed by taxpayer. 7-15-42. Copy served.
Aug. 17—Motion for extension to August 31, 1942 to file brief filed by General Counsel. 8-18-42. Granted.
Aug. 18—Brief filed by General Counsel. Served 8-19-42.
Aug. 26—Motion for extension to September 2, 1942 to file reply brief filed by taxpayer. 8-27-42. Granted.
Aug. 31—Reply brief filed by taxpayer. 8-31-42. Copy served on General Counsel.

1943

Jan. 26—Opinion rendered, Arundell, Judge, Div. 7. Decision will be entered for respondent. 1-27-43. Copy served.

Jan. 27—Decision entered, Murdock, Judge, Div. 3.

Apr. 26—Supersedeas Bond in the amount of $27,774.48 approved and ordered filed.

Apr. 26—Petition for review by U. S. Circuit Court of Appeals, 2nd Circuit, with assignments of error filed by taxpayer.

May 26—Proof of service filed by taxpayer.

June 17—Motion for extension to 8-10-43 to transmit record filed by taxpayer.

June 17—Order enlarging time to August 10, 1943 to prepare and deliver the record entered.

July 21—Joint praecipe for record filed.

3 In the Tax Court of the United States

Petition

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency, issued by the Internal Revenue Agent in Charge for the Second New York Division, dated February 14th, 1941, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation organized and existing under the laws of the State of New York with its principal office at No. 176 Broadway, Borough of Manhattan, City and State of New York, and is the Executor of the Last Will and Testament of Edward T. Bedford. Return for the period here involved was filed with the Collector of Internal Revenue for the Second District of New York.

2. The Notice of Deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on February 14th, 1941.

3. The taxes in controversy are income taxes for the calendar year 1937 in the sum of $13,887.24.

ASSIGNMENTS OF ERROR

4. The determination of the tax set forth in said Notice of Deficiency is based on the following errors:

(a) The Commissioner erred in determining that petitioner received a taxable dividend of $45,240 from the Abercrombie and

Fitch Company upon the recapitalization of said company in 1937.

(b) The Commissioner erred in failing to determine that Abercrombie and Fitch Company was reorganized in accordance with the provisions of Section 112 (b) (3), 112 (c) (1) and 112 (g) (1) of the Revenue Act of 1936, and that the cash of $45,240 received by petitioner in 1937 from said reorganization constituted taxable income only to the extent provided for in Section 112 (c) (1) of the Revenue Act of 1936.

(c) The Commissioner erred in failing to determine that petitioner's taxable profit in 1937 from the reorganization of the Abercrombie and Fitch Company was $18,096.

STATEMENT OF FACTS

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) In 1937 petitioner owned 3,000 shares of 7% Preferred stock (par value $100 per share of the Abercrombie and Fitch Company (hereinafter called the "old stock"), which had been acquired by the said Edward T. Bedford prior to his death and were owned by him at the time of his death. Edward T. Bedford died on May 21, 1931 and the value of said shares on May 21, 1931, as appraised for Federal Estate Tax purposes, was $210,000.

(b) Pursuant to a "Plan of Recapitalization of the Abercrombie and Fitch Company" adopted at a meeting held by the Board of Directors on November 5th, 1936, and approved at a special meeting of the stockholders of the Abercrombie and Fitch Company held on December 8th, 1936, the petitioner received in January, 1937, in exchange for the 3,000 shares of "old stock" ($100 par value per share), the following: 3,000 shares new Preferred stock ($75 par value per share), 1,500 shares Common stock ($1 par value per share) and cash in the amount of $45,240.00. On January 15, 1937, the date of exchange of stock under the above plan, the fair market value of the new securities and cash received under said plan was as follows:

3,000 shares of new Preferred stock	$225,000
1,500 shares Common	15,750
Cash	45,240
Total	285,990

(c) The Commissioner, in his determination of petitioner's taxable profit in 1937 resulting from the said reorganization of Abercrombie and Fitch Company, treated the above-mentioned cash payment of $45,240 as a taxable dividend.

(d) Petitioner in its income tax return for 1937 determined its taxable profit from said reorganization of Abercrombie and Fitch Company in accordance with the provisions of Section 112 (c) (1) and Section 117 (a) of the Revenue Act of 1936. Gain was recognized to the extent of the cash received, namely $45,240 of which 40% constituted taxable income in 1937.

(e) At the time of the adoption of the "Plan of Recapitalization of the Abercrombie and Fitch Company" by its stockholders on December 8, 1936 and at all times thereafter until the exchange of petitioner's shares on January 15, 1937, pursuant to said plan, the Abercrombie and Fitch Company had no accumulated earnings or profits available for distribution as a dividend.

Wherefore, petitioner prays that the Board may hear this proceeding, determine that there is no deficiency in petitioner's
6 income tax liability for the year 1937, and grant such other and further relief to the petitioner as may seem just and proper.

HOLT S. MCKINNEY,
Holt S. McKinney,
Counsel for Petitioner.
Office and Postoffice Address, 122 East 42nd Street,
Borough of Manhattan, City of New York.

(Verified May 12, 1941.)

Exhibit A, annexed to petition

SA-IT-1

TREASURY DEPARTMENT

INTERNAL REVENUE SERVICE

Form 1230 (Emblem) Office of Internal Revenue Agent in Charge, Second New York Division.

Feb. 14, 1941.

ESTATE OF EDWARD T. BEDFORD,
Title Guarantee and Trust Company, Executor,
176 Broadway, New York, New York.

SIRS: You are advised that the determination of your income tax liability for the taxable year ended December 31, 1937,
7 discloses a deficiency of $13,887.24 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing

of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Revenue Agent in Charge, 90 Church St., New York, N. Y., for the attention of LAL–90D. The signing and filing of this form will expedite the close of your return(s) by permitting and early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By C. R. KRIGBAUM,
Internal Revenue Agent in Charge.

Enclosures: Statement. Form of waiver.

8

STATEMENT

TAX LIABILITY FOR TAXABLE YEAR ENDED DECEMBER 31, 1937

Income tax, liability $29,153.40; assessed $15,266.16; deficiency $13,887.24.

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated December 29, 1938; to your protest dated September 6, 1940; and to the statements made at the conferences held on August 26 and October 18, 1940, and January 22, 1941.

A copy of this letter and statement has been mailed to your representative, Mr. Henry F. Matheis, 176 Broadway, New York, New York, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return		$65,701.76
Unallowable deduction and additional income: (a) Dividends	45,240.00	
Total		110,941.76
Nontaxable income and additional deduction: 25% capital gain		18,098.00
Net income adjusted		92,843.76

9

EXPLANATION OF ADJUSTMENTS

(a) The amount of $45,240.00, representing cash received upon recapitalization of Abercrombie and Fitch Company (New York):

is held to be taxable as a dividend under the provisions of the Revenue Act of 1936.

(b) Amount of $18,096.00 taken into account in determining capital gains reported on the return has been eliminated as a result of adjustment (a), supra.

COMPUTATION OF TAX, REVENUE ACT OF 1936

Net income adjusted	$92,845.76
Less: Personal exemption	1,000.00
Balance (surtax net income)	91,845.76
Net income subject to normal tax	91,845.76
Normal tax at 4% on $91,845.76	3,673.83
Surtax on $91,845.76	25,515.17
Total tax	29,189.00
Less: Income tax paid at the source	35.60
Correct income tax liability	29,153.40
Income tax assessed: Original Account No. 187006	15,265.16
Deficiency of income tax	13,887.24

10 In the Tax Court of the United States

Answer.

The respondent by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition heretofore filed in this proceedings, admits, denies and avers as follows:

1. Admits the allegations in paragraph 1 of the petition.

2. Admits the allegations in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1937, but denies all other allegations in paragraph 3 of the petition.

4. Denies the allegations in subparagraphs (a), (b), and (c) of paragraph 4 of the petition.

5. (a) Admits the allegations in subparagraph (a) of paragraph 5 of the petition.

(b) Admits all the allegations in subparagraph (b) of paragraph 5 of the petition, except that respondent denies that the fair market value of the new securities is as alleged in said subparagraph.

(c) Admits the allegations in subparagraph (c) of paragraph 5 of petition.

(d) (e) Denies the allegations in subparagraphs (d) and (e) of paragraph 5 of the petition.

11 Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petition herein be denied.

J. P. WENCHEL,
H. D. T.
J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
E. C. ALGIRE,
Division Counsel,
HENRY C. CLARK,
Special Attorney,
Bureau of Internal Revenue.
HCC:GEB 6/11/41.

12 In the Tax Court of the United States

Docket No. 107302

TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR OF THE LAST WILL AND TESTAMENT OF EDWARD T. BEDFORD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Motion to amend the caption of the proceeding

Comes now the petitioner by its counsel, Holt S. McKinney, and moves for an order by the Board amending the caption of the above proceeding so as to make it read as follows:

Docket No. 107302

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

And for cause of this motion petitioner says that said amendment is requested in order to make the caption in the above
13 proceeding conform with the provisions of Rule 4 of the Rules of Practice before the United States Board of Tax Appeals, as revised April 1, 1941.

Wherefore, it is prayed that this motion be granted.

HOLT S. MCKINNEY,
Counsel for Petitioner.

In the Tax Court of the United States

Order amending caption of the proceeding

On motion of counsel for the petitioner, it is

Ordered, that the caption of the proceeding at the above docket number be and it is hereby amended to read Estate of Edward T. Bedford, Title Guarantee and Trust Company, Executor, Petitioner, v. Commissioner of Internal Revenue, Respondent.

[SEAL] (S) C. R. ARUNDELL,
Member.

Dated: Washington, D. C., June 3, 1941.
FBH.
cgh.

14 In the Tax Court of the United States

Stipulation of facts

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys of record, for the purpose of a trial of this action and all other proceedings herein, that the facts hereinafter stated shall be taken as true; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other evidence not inconsistent with the facts herein stipulated.

1. The petitioner is a corporation organized and existing under the laws of the State of New York with its principal office at No. 176 Broadway, Borough of Manhattan, City and State of New York, and is the Executor of the Last Will and Testament of Edward T. Bedford. Petitioner's income tax return for the taxable year ended December 31, 1937, was duly filed with the Collector of Internal Revenue for the Second District of New York. The return disclosed a total income tax in the amount of $15,266.16, which was duly paid.

2. In 1937 petitioner owned 3,000 shares of 7% Cumulative Preferred Stock (par value $100 per share) of the Abercrombie and Fitch Company, which shares of stock had been acquired by the said Edward T. Bedford prior to his death and were owned by him at the time of his death. Edward T. Bedford died on May 21, 1931, and the fair market value on May 21, 1931, of said 3,000 shares of 7% Cumulative Preferred Stock of Abercrombie and Fitch Company was two hundred and ten thousand dollars ($210,000).

3. In accordance with a "Plan of Recapitalization of the Abercrombie and Fitch Company" adopted at a meeting held by the Board of Directors on November 5, 1936, and approved at a special meeting of the stockholders of the Abercrombie and Fitch Company held on December 8, 1936, the petitioner received in January, 1937, in exchange for the said 3,000 shares of 7% Cumulative Preferred Stock ($100. par value per share) of the Abercrombie and Fitch Company, the following: 3,500 shares of the Cumulative Preferred Stock of the Abercrombie and Fitch Company of a par value of $75. per share and an annual dividend of $6. per share; 1,500 shares of the Common Stock of the Abercrombie and Fitch Company of a par value of $1. per share; and cash in the amount of $45,240. A copy of the said "Plan of Recapitalization of the Abercrombie and Fitch Company" is hereto attached and marked Exhibit A, together with a copy of the notice of the approval of said plan by the stockholders on December 8, 1936—marked Exhibit B.

4. On January 15, 1937, the date petitioner exchanged its 3,000 shares of 7% Cumulative Preferred Stock of Abercrombie and Fitch Company in accordance with said "Plan of Recapitalization of the Abercrombie and Fitch Company", the fair market value of the new securities and cash received by petitioner under the said plan was as follows:

	Fair market value
3,500 shares new Cumulative Preferred Stock of the Abercrombie and Fitch Company of a par value of $75. per share and an annual dividend of $6. per share	$288,750
1,500 shares of the Common Stock of the Abercrombie and Fitch Company of a par value of $1. per share	15,750
Cash of $45.08 per share	45,240
Total Fair Market Value	349,740

5. On January 31, 1936 the Surplus Account, per books, of the Abercrombie and Fitch Company showed a deficit of $399,771.87, after deduction of three stock dividends, which respondent contends are not proper charges to surplus. A summary analysis of this Surplus Account from January 1, 1913 to January 31, 1936, is hereto attached and marked Exhibit C.

6. For the taxable year ended January 31, 1937 the Abercrombie and Fitch Company had net earnings after taxes of $309,073.70.

Dated: New York, N. Y., May the 27th 1942.

HOLT S. MCKINNEY,
Attorney for Petitioner.

(Signed) J. P. WENCHEL'S
RPH
Attorney for Respondent.

17 *Exhibit A, annexed to stipulation of facts*

ABERCROMBIE & FITCH COMPANY

MADISON AVENUE AT 45TH STREET, NEW YORK

Notice of Special Meeting of Stockholders to be held 11 o'clock a. m., December 8, 1936.

Letters of President, Plan of Recapitalization, and Proposed Amendment of Certificate of Incorporation

19 ABERCROMBIE & FITCH COMPANY.

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

Notice is hereby given that a Special Meeting of the Stockholders of Abercrombie & Fitch Company will be held at its principal and registered office, Madison Avenue at 45th Street, New York, on the 8th day of December, 1936, at 11:00 o'clock in the forenoon for the following purposes:

1. To consider and act upon a plan for the recapitalization of the Corporation (including an increase of the number of its shares to 121,000 shares, the present authorized 20,000 shares of Preferred or Preference Stock, with a cumulative annual dividend rate of 7%, being changed into 21,000 shares of new Sinking Fund Preferred Stock with a par value of $75 per share, and an annual dividend rate of $6.00 per share per annum, the dividends on the Preferred Stock to be cumulative from and after January 1, 1937, and the Preferred Stock being subject to call and redemption, and the previously authorized shares of Common Stock without par value being changed into the same number of shares with par value of $1.00 per share and the changing of the designations, preferences and privileges and voting powers or restrictions or qualifications of the shares of each class of stock, and a reduction of the amount of the capital of the Corporation), as declared advisable and set forth in a resolution adopted by the Board of Directors of the Corporation at a meeting held November 9th, 1936, copy of which, marked "Exhibit A," is annexed hereto and made a part hereof.

2. To consider and act upon a proposed amendment of the
20 Certificate of Incorporation, as heretofore amended, which amendment has been proposed and declared advisable by the Board of Directors in and by said resolution and as fully set forth in said copy thereof, marked "Exhibit A", annexed hereto and made a part hereof.

3. To transact such other business in conenction with the foregoing matters or otherwise, as may properly come before the meeting or any adjournment or adjournments thereof.

The Transfer Books will not be closed but only stockholders of record at the close of business on November 18, 1936, will be entitled to notice of and to vote at said meeting or any adjournment or adjournments thereof.

Stockholders who will be unable to attend the meeting in person are requested to date, sign and promptly mail the enclosed proxy, in the envelope herewith.

By order of the Board of Directors.

F. L. McAFEE,
Secretary.

Dated, November 12th, 1936.

The Signature on the proxy should correspond with name of the Stockholder as it appears on the envelope by which this notice is received.

A proxy to be executed by a corporation should be signed in its name by its President or other officer duly authorized to sign the same, and its corporate seal should be affixed and attested by its Secretary or other proper officer.

Executors, Administrators and Trustees should execute the proxy in the same manner as is done by them in executing formal legal documents.

21

MADISON AVENUE AT 45TH STREET.
New York, N. Y., November 12th, 1936.

To the Stockholders of ABERCROMBIE & FITCH COMPANY:

There is submitted herewith for your consideration a proposed Plan of Recapitalization of the Company.

Perhaps, I should explain immediately why recapitalization in this particular instance is necessary and what it means to stockholders.

In the early years of the depression we incurred losses as a result of which we accumulated a deficit.

Under the New York State Laws we are not permitted to pay dividends except out of surplus or earnings, and regardless of what our current earnings may be we cannot pay a dividend to shareholders while we have a deficit. Our earnings today are such that we may appropriately pay a dividend to Preferred and Preference shareholders if the required number of shareholders agree to a plan which makes such a payment legal.

If you will study this plan as presented herewith, you will see that the intent of this proposal has been to create a situation so

that Preferred and Preference shareholders may immediately share in the earnings of the Company.

The present total authorized capital stock is 120,000 shares, of which 20,000 shares are 7% Cumulative Preferred or Preference Stock with a par value of $100 per share, and 100,000 shares are no par value Common Stock with a stated value of $5.00 per share. Of the foregoing 17,973 shares of the 7% Cumulative Preferred or Preference Shares and 71,800 shares of the Common Stock are issued and outstanding.

22 No dividends have been paid on either of the Preferred and Preference or Common Stocks since October 1, 1931 and the accumulations upon the former stock at the rate of 7% per annum amounted on July 1, 1936, to $33.25 per share.

Accompanying the plan you will find a copy of the report of Messrs. Haskins & Sells, Certified Public Accountants, containing a consolidated Balance Sheet showing the financial position of the Company as of July 31, 1936. The report also contains a pro forma consolidated Balance Sheet as of the same date, after giving effect to the proposed recapitalization as set forth in the resolution adopted by the Board of Directors recommending the plan.

The Board of Directors has felt that a plan which would dispose of the accumulated arrears of dividends on the present outstanding 7% Cumulative Preferred or Preference Shares and prepare the way for resumption of dividend payments on a current basis would be most desirable and would be favorably considered by all the Stockholders.

To this end the Board of Directors directed its Executive Committee to consider the matter, and formulate a plan, which the Committee has done and which the Board of Directors after careful consideration has approved. The plan submitted herewith and marked "Exhibit A," provides substantially as follows:

(1) For the increase of the total authorized shares from 120,000 to 121,000 of which 21,000 are to be Cumulative Sinking-Fund Preferred Stock of a par value of $75 per share, with an annual dividend rate of $6. per share and of a voluntary liquidating or call value of $106.50 per share, and an involuntary liquidating value of $100. per share; and 100,000 shares are to be Common Stock of a par value of $1. per share.

(2) The holders of the 7% Cumulative Preferred or Preference Stock shall receive in exchange for each share of such
23 stock and in full satisfaction, liquidation, and discharge of all accumulated dividends to and including December 31, 1936, and any and all other rights, preferences, or claims thereon, one and one-sixth shares of the fully paid and non-assessable,

Cumulative Sinking Fund Preferred Stock with an annual dividend rate of $6. per share, and one-half share of the fully paid and non-assessable Common Stock with a par value of $1. per share, and $15.08 in cash.

The holders of the no par value Common Stock are to receive in exchange for each share thereof, one share of the new Common Stock having a par value of One ($1.00) Dollar.

(3) That the voting power shall be in the Common Stock, except upon three (3) consecutive defaults in paying the half yearly dividend on the Cumulative Preferred Stock, whereupon the Preferred Shares shall have the exclusive right to the election of Directors until all back dividends and current dividends thereon shall have been paid in full, and except as otherwise provided for in the Certificate of Incorporation. So long as 25% of the total authorized new Preferred Stock is issued and outstanding the holders of all of the new Preferred Stock shall have the right to elect approximately one-third of the members of the Board of Directors.

(4) That the holders of the 7% Cumulative Preferred or Preference Shares and of the no par value Common Shares shall have until December 31, 1936, to deposit their shares and receive the new shares in exchange. Dividends on the new Preferred Stock shall begin to accrue as of January 1, 1937, and no dividend thereafter will be accrued or paid upon the old Preferred or Preference Stock.

24 (5) The Company may deposit in escrow with the Chase National Bank of the City of New York or such other bank in the City of New York as the Board of Directors may select, the new shares to which any nonexchanging shareholder would have been entitled to receive if such shareholder had made such exchange within the time limit, and the dividends on the new shares so deposited in escrow may likewise be deposited with such escrow bank.

If the proposed plan and amendment of the Certificate of Incorporation of the Company become effective, notice of the time and place for presenting the old shares for exchange will be hereafter given.

There is to be no arrangement for underwriting as the proposed plan is merely a readjustment of the interests of the Stockholders in the Corporation, and no commission or other remuneration is to be paid or given, directly or indirectly, for or upon the exchange of your stock.

It is believed that the exchange of the old 7% Cumulative Preferred or Preference Stock for the new $6 Cumulative Preferred Stock, will not result in any taxable gain or deductible loss for

the purpose of Federal or New York State Income Taxes, but that the cash payment of $15.08 per share will be taxable.

A two-thirds vote of each class of stock outstanding as of the close of business on November 18, 1936, will be necessary to make the plan effective.

Your Corporation has been most fortunate in being able to emerge, to the extent it has, from the depression years of low prices and most unsatisfactory business conditions and this, and the knowledge that the Directors, Officers and entire personnel have given untiring efforts to make this possible should be gratifying to the Stockholders.

You are requested to sign and promptly return the enclosed proxy. Executors, Administrators and Trustees are requested to submit therewith a certificate of recent date, showing their appointment as such.

On behalf of the Board of Directors,

By JAMES S. COBB,
President.

Exhibit A

PLAN OF RECAPITALIZATION OF THE ABERCROMBIE & FITCH COMPANY

Resolution by the Board of Directors adopted at a meeting held on November 5th, 1936.

Resolved, that the Board of Directors of the Abercrombie & Fitch Company hereby declares that it is advisable:

(1) That the total authorized capital stock of the Company consisting of 120,000 shares, of which, 20,000 shares are 7% Cumulative Preferred or Preference Stock of a par value of $100.00 each and 100,000 shares are Common Stock of no par value, but with a stated value of $5.00 each, be changed into 121,000 shares, of which 21,000 shares are to be Cumulative Preferred Stock of a par value of $75.00 each, and of which 100,000 shares are to be Common Stock with a par value of one ($1.00) dollar each.

(2) That the said Cumulative Preferred Stock shall (a) be entitled to annual dividends at the rate of $6.00 per share Cumulative from and after January 1st, 1937, before any dividends shall be paid or set apart on the Common Stock and, after paying or setting apart dividends at the rate of $6.00 per share per annum on the Cumulative Preferred Stock the Common Stock only shall participate in the net earnings of the Company applicable to dividends; (b) be subject to call and redemption; (c) be paid in case of voluntary liquidation or dissolution

or distribution of assets of the Company the sum of $106.50 per share, plus dividends accumulated and unpaid thereon after January 1st, 1937, except as otherwise stated aforesaid; (d) be paid in case of involuntary liquidation or dissolution or distribution of assets of the Company the sum of $100.00 per share, plus dividends accumulated and unpaid thereon after January 1st, 1937, except as otherwise stated aforesaid.

That in case of liquidation or dissolution or distribution of assets of the Company, whether the same be voluntary or involuntary, and after payment of all unpaid cumulative dividends, and the sum per share to which the Preferred is entitled, the remaining assets of the Company shall be payable to the Common Shares; that the Common Stock shall have the sole voting power except as otherwise provided in the hereinafter proposed amendment of the Certificate of Incorporation.

(3) That when the amendment, as hereinafter provided, of the Certificate of Incorporation of the Company becomes effective, the holders of the outstanding shares of the 7% Cumulative Preferred or Preference Stock shall cease to become holders of such shares respectively and shall be and become respectively holders of and entitled to receive one and one-sixth shares of the Cumulative Preferred Stock of a par value of $75.00 and an annual dividend of $6.00 per share, and one-half share of the Common Stock of a par value of $1.00 per share, and $15.08 in cash, for each one share of 7% Cumulative Preferred or Preference Stock held by them respectively as of the close of business, December 31, 1936; that thereafter the holders of the present outstanding 7% Cumulative Preferred or Preference Stock shall cease to be entitled to any rights, privileges or claims (in-
27 cluding, but not by way of limitation of the generality of the foregoing, any rights or claims of whatever kind or character, to any and all unpaid accumulated dividends accrued or in arrears upon the shares of 7% Cumulative Preferred or Preference Stock) which they heretofore had or may now or hereafter have by reason of the holding or owning of shares of such 7% Cumulative Preferred or Preference Stock, except the right to receive the said Cumulative Preferred Stock with a par value of $75.00 per share and the One ($1.00) dollar par value Common Stock and cash above mentioned in exchange therefor; and that each and all such rights, preferences, privileges and claims shall in all respects be forever released, discharged and extinguished and of no force or effect whatsoever; that in respect to all shares of the 7% Cumulative Preferred or Preference Stock not deposited for exchange on or before the date above provided, the Company through its proper officers or officer may deposit

in a special account with a solvent bank or trust company doing business in the Borough of Manhattan, City and State of New York, the shares of the Cumulative Preferred Stock with a par value of $75.00 and the Common Stock and the cash to which the holder of such 7% Cumulative Preferred or Preference Stock would be entitled to have received if such holder had so deposited his or her or its 7% Cumulative Preferred or Preference Stock as required in notice to be given to such Preferred or Preference Stock holders; and that the holders of the no par value Common Stock shall cease to become holders of such shares respectively and shall be and become respectively holders of and entitled to receive one share of the $1.00 par value Common Stock for each one share of no par value Common Stock held by them respectively as of the close of business on the 31st day of December, 1936.

(4) That upon the consummation of the recapitalization herein provided for, appropriate changes and adjustments be made on the books, records and statements of the Company and its subsidiaries, to give effect to the changes in the capital of the Corporation as herein provided.

(5) The Certificate of Incorporation of the Company as heretofore amended, be amended, changed and altered to read as follows:

Certificate of increase of the number of shares and reduction of par value of preferred or preference shares and change of shares without par value into shares with par value and classification and reclassification of shares and change regarding the designations, preferences, privileges and voting powers or restrictions or qualifications of the shares of each class of stock and reduction of the amount of the capital of Abercrombie & Fitch Company, pursuant to Section 36 of the Stock Corporation Law.

We, the undersigned, James S. Cobb and F. L. McAfee, being respectively the President and Secretary of Abercrombie & Fitch Company, hereby certify:

First. The name of the corporation is Abercrombie & Fitch Company.

Second. The date of the filing of the Certificate of Incorporation in the office of the Secretary of State of New York, is November 1st, 1904.

Third. The amount of the capital of the corporation is Two Million One Hundred Fifty-six thousand three hundred ($2,156,300) dollars.

Fourth. The total number of shares which the corporation is already authorized to issue is One Hundred Twenty thousand (120,000) shares of which Twenty thousand (20,000) shares having a par value of One hundred ($100.) dollars each are Preferred

or Preference and One hundred thousand (100,000) shares without par value are Common.

The designations, preferences, privileges and voting powers, or restrictions or qualifications of said Preferred or Preference Stock and said Common Stock are as follows:

(a) The Preference Stock is senior to the Common Stock, and the Common Stock is subject to all the rights and preferences of the Preference Stock as herein set forth.

(b) The holders of the Preference Stock shall be entitled to receive, and the Corporation shall be bound to pay thereon, dividends at the rate of seven per centum (7%) per annum and no more, payable in cash quarterly on the first days of January, April, July and October in each year, as and when declared by the Board of Directors, out of the surplus of the Corporation. Such dividends shall be cumulative but arrears thereof shall be paid without interest. Such dividends shall accrue, in the case of shares issued prior to April 1, 1928, from January 1, 1928, and in the case of shares issued on or after April 1, 1928, from the first day of the dividend period in which such shares are issued. Such dividends shall be deemed to accrue from day to day, regardless of whether or not earned or declared.

(c) In no event, so long as any Preference Stock is outstanding, shall any dividend whatsoever be declared or paid on any junior class of stock, or shall any distribution of capital, surplus or profits be made on any junior class of stock, or shall any shares of any junior class of stock be purchased or redeemed by the Corporation, or shall any moneys be paid to or made available for any sinking fund for the purchase or redemption of any junior class of stock:

(1) Unless the full quarterly dividends on the Preference Stock for all past quarterly dividend periods shall have been paid and the quarterly dividend on the Preference Stock for the current quarterly dividend period shall have been paid or declared and set apart in full;

(2) Unless the Corporation has made the payment, if any, then due under the requirements of the Preference Stock sinking fund for the then current year, and all defaults, if any, in complying with said sinking fund requirements in respect of previous years have been made good; and

(3) Unless the surplus of the Corporation (and its subsidiaries, if any, on a consolidated basis), excluding from the computation thereof for this particular purpose all items of goodwill and similar intangibles, after adequate reserves or deductions for all taxes, depreciation, uncollectible debts, contingent liabilities, and all proper accounting charges, and with

proper eliminations for any inter-company accounts, shall be in excess of the amount of $400,000 and the payment of such dividends on any junior class of stock of the Corporation, or the taking of such other action, shall not reduce such surplus below said amount; provided that in determining the amount of such surplus there shall not be included;

(I) Surplus arising from an increase in the value of any assets, unless actually realized upon sale or other disposition thereof; or

(II) Surplus used for the purchase or the acquisition by the Corporation of shares of any class of its stock other than the Preference Stock, or created or growing out of the acquisition or retirement by the Corporation of shares of any other class of its stock; or

(III) Surplus arising from any change in par value, stated capital, or capital attributable to its shares of stock of any class.

(d) Subject to all the rights of the Preference Stock, dividends may be paid on the Common Stock, as and when declared by the Board of Directors, out of the surplus of the Corporation.

(e) Upon any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, the Preference Stock shall be entitled, before any distribution is made to any class of stock junior to the Preference Stock, to be paid the sum of $110 per share, and an amount equal to all unpaid cumulative dividends, whether earned or declared or not, which have accrued thereon to the date of distribution upon liquidation; but the Preference Stock shall not be entitled to any further pay-
32 ment, and the remaining net assets of the Corporation shall be distributed pro rata to the Common Stock.

(f) Except as otherwise provided in this certificate of incorporation and the amendments thereto, or as otherwise required by law, the Preference Stock shall have no right to vote for the election of directors or for any other purpose (including a proceeding for mortgaging the property and franchises of the Corporation, for guaranteeing the bonds of another corporation, for the sale of the franchises and property, for establishing priorities or creating preferences among the several classes of stock, for consolidation, for voluntary dissolution, or for change of name), and shall not be entitled to receive notice of any meeting of stockholders, and all voting rights for the election of directors, and for authorizing any corporate action whatsoever required to be authorized by the stockholders, and for all other purposes, shall be vested exclusively in the Common Stock; provided, however, that if and whenever six quarterly dividends on the Preference Stock shall be unpaid in whole or in part, then the Preference Stock shall be entitled to the exclusive voting right for the election of directors, until all arrears

in dividends on the Preference Stock shall have been paid in full and the quarterly dividends thereon for the current quarterly dividend period shall have been declared and set apart in full (which shall be done as expeditiously as practicable), and thereupon the exclusive voting right for the election of directors shall be divested from the Preference Stock and revested in the Common Stock.

In any case, where the Preference Stock shall become vested with the exclusive voting right for the election of directors, a meeting of the Preference stockholders shall forthwith be called and at such meeting the Preference stockholders may, by a vote of a majority of all the shares of Preference Stock outstanding,
33 remove from office all directors then holding office and elect a new Board of Directors.

Similarly, in any case where the Common Stock shall become re-vested with the exclusive voting right for the election of directors, a meeting of the Common stockholders shall forthwith be called, and at such meeting the Common stockholders may, by a vote of a majority of all the shares of Common Stock outstanding, remove from office all directors then holding office and elect a new Board of Directors.

Each stockholder entitled to vote at any particular time in accordance with the foregoing provisions, shall have one vote for each share of the stock at the time entitled to voting rights held of record by him on the date fixed for determining voting rights.

(g) The affirmative vote of the holders of at least two-thirds ($^2/_3$) in interest of the Preference Stock at the time outstanding, given in person or by proxy, at a meeting called for the purpose, at which the Preference Stock shall vote separately as a class, shall be necessary for effecting or validating any one or more of the following:

(1) Any authorization, creation or issue of any new class of stock having any preference or priority which is or would be superior to or on an equality with any preference or priority of the Preference Stock provided for herein; or any authorization, creation or issue of any obligation or security convertible into or evidencing the right to purchase any stock having any such preference, priority or equality; provided that the provisions of this sub-paragraph (1) shall not apply to the authorization, creation or issue of additional shares of the Preference Stock; or

(2) Any issue of shares of Preference Stock in excess of a
34 total of 3,000 shares; provided that such affirmative vote shall not be necessary for effecting or validating any such issue if the net earnings of the Corporation (and its subsidiaries, if any, upon a consolidated basis), plus the net earnings of the properties, if any, to be acquired by all or any part of the proposed

issue of Preference Stock or the proceeds thereof shall for a period of twelve (12) successive calendar months ending within the ninety (90) days immediately preceding such issue, amount to not less than two and one-half times, or shall for a period of twenty-four successive calendar months ending within the ninety (90) days immediately preceding such issue, amount to five times the aggregate annual dividend requirements on the shares of Preference Stock outstanding and those then proposed to be issued; or

(3) Any amendment of this certificate of incorporation which would alter or change the preferences of the Preference Stock; or

(4) The creation of any mortgage, lien, charge or encumbrance of any kind upon any part of the real or personal property of the Corporation or of any subsidiary; or the creation of any bonds, notes, or other evidences of indebtedness maturing more than eighteen months from the date of issue; provided, however, that this restriction shall not apply to:

I. The giving of purchase money mortgages or other purchase money liens on property that may hereafter be acquired by the Corporation or any subsidiary; or the renewal or refunding of such mortgages; or

II. The acquisition of property subject to mortgages, liens, charges or encumbrances thereon then existing; or the renewal or refunding of such mortgages; or

III. The pledging by the Corporation or by any subsidiary, as security for loans made to it in the regular and current conduct of its business, or notes, accounts receivable, merchandise, stocks, bonds or other securities or other liquid assets owned by it, other than obligations, securities or stock of any subsidiary.

The term "Subsidiary" as used in this certificate of amendment shall include any corporation a majority of whose outstanding stock having voting power under ordinary circumstances is at the time owned or controlled, directly or indirectly, by the Corporation or by another subsidiary. The term "net earnings" shall mean the net income of the Corporation (and its subsidiaries, if any, upon a consolidated basis, with proper eliminations for inter-company accounts and with proper allowances for stock interest not owned by the Corporation in subsidiaries), after proper deductions for depreciation, all taxes and other items applicable to the period in accordance with good accounting practice, but without any deduction or allowance on account of dividend or sinking fund payments.

When under the provisions of sub-paragraph (2) of this paragraph (g), the net earnings of the Corporation (and its subsidiaries, if any, upon a consolidated basis) are required to be

computed for a stated period, and any properties have been acquired by the Corporation or its subsidiaries which were not owned by the Corporation or its subsidiaries during all or part of the period for which such computation is to be made, then and in every such case the net earnings of such properties during the entire period for which the computation is to be made shall be treated and considered as part of the net earnings of the Corporation for such period.

(h) The Corporation, at the option of the board of directors, may redeem the whole or from time to time redeem any part
36 of the Preference Stock on any dividend date, by paying therefor in cash $112.50 per share plus an amount equal to all unpaid cumulative dividends, whether earned or declared or not, accrued thereon to and including the date of redemption, such sum being hereinafter sometimes referred to as the redemption price. In case of the redemption of a part only of the outstanding Preference Stock, the Corporation shall designate by lot, in such manner as the board of directors may determine, the shares to be redeemed, or shall effect such redemption pro rata. At least thirty (30) days' previous notice by mail, postage prepaid, shall be given to the holders of record of the Preference Stock to be redeemed, such notice to be addressed to each such stockholder at his post office address as shown by the records of the Corporation. On or after the date of redemption stated in such notice, each holder of Preference Stock called for redemption shall surrender his certificate for such stock to the Corporation at the place designated in such notice and shall thereupon be entitled to receive payment of the redemption price. In case less than all the shares represented by any such surrender certificate are redeemed a new certificate shall be issued representing the unredeemed shares. If such notice of redemption shall have been duly given, and if on or before the redemption date funds necessary for the redemption shall have been set aside so as to be and continue available therefor, then, notwithstanding that the certificates representing any shares of Preference Stock so called for redemption shall not have been surrendered, the dividends thereon shall cease to accrue after the date of redemption and all rights with respect to the shares so called for redemption shall forthwith after such redemption date cease and determine, except only the right of the holders to receive the redemption price without interest. At any time after giving notice of redemption, as aforesaid, of all or any part of the Preference Stock, the
37 Corporation may deposit with a bank or trust company in the Borough of Manhattan, City and State of New York, as a trust fund for the benefit of the holders of the shares called for redemption, an amount in cash sufficient to pay the re-

demption price of such shares. After the making of such deposit, such shares shall not be deemed to be outstanding for any purpose, and the rights of the holders thereof shall be limited to the right to receive payment of the redemption price from such fund upon surrender of the certificates on or after the redemption date. Subject to the provisions hereof, the board of directors shall have authority to prescribe from time to time the manner in which Preference Stock shall be redeemed.

(i) The Preference Stock shall be entitled to the benefit of a sinking fund as set forth in this paragraph (i). On May 15th in the year 1929 and in each year thereafter so long as any Preference Stock remains outstanding, the Corporation shall make available out of its surplus which would at the time be legally available for the declaration of dividends an amount of money sufficient to redeem on the first day of July next following two and one-half per cent (2½%) of the maximum aggregate amount of Preference Stock which shall have been issued prior to said May 15, regardless of whether all of such previously issued Preference Stock shall then be outstanding. The amount of money so made available shall be applied to the redemption on such July 1st of shares of Preference Stock determined by lot or pro rata. In any year during which this sinking fund provision shall be operative, the Corporation, instead of making available all or part of said amount in cash, may surrender to the sinking fund, not later than May 15th, shares of Preference Stock, which, after being outstanding, have been purchased or otherwise acquired by the Corporation and have not previously been surrendered to the sinking fund, and the Corporation shall be credited against the cash sinking fund requirement for that year with a sum equal to the redemption price as of July 1st of the shares of Preference Stock so surrendered to the sinking fund. No Preference Stock shall be purchased or redeemed under this provision or otherwise during the continuance of any default in the payment of cumulative dividends on the Preference Stock. All Preference Stock redeemed by the sinking fund or otherwise or surrendered to the sinking fund shall be transferred into the name of the Corporation and shall not be reissued or otherwise disposed of, and no Preference Stock shall be issued in lieu thereof, and the Corporation may from time to time take such action (if any) as may be necessary to cause all such shares so redeemed or surrendered to be retired in any manner permitted by law.

(j) No holder of Common Stock and no holder of Preference Stock shall be entitled, as such, as a matter of right, to subscribe for or purchase any part of any new or additional issue of Com-

mon Stock, Preference Stock, or any other class of stock whatsoever, or of securities convertible into or evidencing the right to purchase any such class of stock, whether now or hereafter authorized, or whether issued for cash, property or services, or otherwise; except that no shares of Common Stock or of any new class of Common Stock and no securities convertible into or evidencing the right to purchase such stock shall be issued for money without being offered for subscription pro rata to the holders of the outstanding Common Stock.

(k) In case for the fiscal year ended December 31, 1925, and for any subsequent fiscal year ending on January 31, ten percent (10%) of the Corporation's net earnings (computed as provided in paragraph (g) of Article 5 hereof, but excluding, in the case of properties acquired by the Corporation or its subsidiaries during such fiscal year, such part of the net earnings of such properties as apply to the portion of such fiscal year prior to their acquisition) shall exceed the amount of money to be made available for the sinking fund on the May 15th next following to redeem two and one-half percent (2½%) of the maximum aggregate amount of Preference Stock which shall have been issued prior to such May 15th, then the Corporation on such May 15th shall also make available for the sinking fund out of its surplus which would at the time be legally available for the declaration of dividends, an additional amount of money equal to the excess of ten percent (10%) of such net earnings over the two and one-half percent (2½%) of such maximum aggregate amount of Preference Stock (with the same privilege to the Corporation of surrendering Preference Stock instead of making all or part of said additional amount available in cash as in the case of the other amount to be made available to the sinking fund).

Fifth. The number of shares of each class issued and outstanding is as follows: Seventeen thousand nine hundred and seventy-three (17,973) shares of Preferred or Preference Stock and Seventy-one thousand eight hundred (71,800) shares of Common Stock.

Sixth. The total number of shares including those previously authorized, which the Corporation may henceforth have is: One hundred and twenty-one thousand (121,000) shares, of which Twenty-one thousand (21,000) shares are to have a par value of Seventy-five ($75.00) Dollars each; and of which One hundred thousand (100,000) shares are to have a par value of One ($1.00) Dollar each.

Seventh. The Twenty thousand (20,000) previously authorized shares of Preferred or Preference Stock of a par

value of One hundred ($100.) Dollars each issued or unissued are changed into Twenty-one thousand (21,000) shares of Preferred Stock with a par value of Seventy-five ($75.00) Dollars each hereby authorized, and One hundred thousand (100,000) previously authorized shares of Common Stock without par value issued or unissued are changed into One hundred thousand (100,000) shares of Common Stock with a par value of One ($1.00) Dollar per share hereby authorized.

Eighth. The One hundred twenty-one thousand (121,000) shares which the Corporation may henceforth issue are to be classified and reclassified as above stated into Twenty-one thousand (21,000) shares of Preferred Stock with a par value of Seventy five ($75.00) Dollars each and One hundred thousand (100,000) shares of Common Stock with a par value of One ($1.00) Dollar each; and the designations, preferences, privileges and voting powers of the shares of each class, and the restrictions or qualifications thereof are as follows:

DIVISION "A"—PREFERRED STOCK.

(1) Dividends: The holders of the Preferred Stock shall be entitled to receive, out of the surplus or net earnings of the corporation, if, when and as declared by the Board of Directors in its discretion, preferential dividends at the fixed rate of Six ($6.00) Dollars per share per annum and no more, payable semi-annually, on the first days of January and July in each year, as the Board of Directors may from time to time determine, before any dividends shall be declared or paid upon, or set apart for, or other
41 distribution shall be ordered or made in respect of the Common Stock. Such dividends on the Preferred Stock shall be cumulative from January 1, 1937, so that, if full cumulative dividends on the outstanding Preferred Stock at the rate aforesaid from January 1, 1937 to the end of the then current dividend period shall not have been paid thereon or declared and a sum sufficient for the payment thereof set apart, the amount of the deficiency shall be fully paid, but without interest, or dividends upon the Preferred Stock in such amount shall be declared and a sum sufficient for the payment thereof set apart, before any dividends shall be declared or paid upon or set apart for, or any other distribution shall be ordered or made in respect of the Common Stock, and before any sums shall be paid or set apart for the redemption of less than all of the Preferred Stock then outstanding, or for the purchase or other retirement of any of the Preferred Stock as hereinafter provided. In the event of the issue of any additional shares of Preferred Stock subsequent to January 1, 1937, all dividends paid on the Preferred Stock prior to the issue of such addi-

tional shares and all dividends declared payable to holders of record of Preferred Stock of a date prior to such issue shall be deemed to have been paid in respect of the additional shares so issued. The first semi-annual dividend on the Preferred Stock shall be payable on July 1, 1937.

(2) Preference upon Liquidation, etc. (a) In the event of any voluntary liquidation, dissolution or winding up of the Corporation, or any reduction of its capital, resulting in any distribution of its assets to its stockholders, the holders of the Preferred Stock shall be entitled to receive, for each share thereof, out of the assets of the Corporation, whether from capital, surplus, or earnings available for distribution to its stockholders, an amount equal to One hundred and six and 50/100 ($106.50) Dollars per share, together with an amount equal to all dividends ac-
42 crued or in arrears thereon, whether or not earned, before any distribution of assets of the Corporation shall be made to the holders of the Common Stock; but the holders of Preferred Stock shall be entitled to no further participation in such distribution. If upon any such voluntary liquidation, dissolution, winding up of reduction, the assets of the Corporation, distributable as aforesaid among the holders of the Preferred Stock, shall be insufficient as to payment to them of the full preferential amounts aforesaid, then the entire net assets of the Corporation to be distributed shall be distributed ratably among the holders of the Preferred Stock in proportion to the full preferential amounts to which they are respectively entitled. As used herein, the expression "dividends accrued or in arrears" means, in respect of each share of the Preferred Stock an amount equal to Six ($6.00) Dollars per share, per annum from the date from which dividends thereon became cumulative to the date as of which the computation is to be made, less the aggregate amount (without interest) of all dividends theretofore paid (or deemed to have been paid) thereon, or declared and set aside for payment, in respect thereof. Nothing in this paragraph (2) (a) shall be deemed to prevent the purchase or redemption of Preferred Stock, in any manner permitted by law or herein provided for; provided, however, that anything in this certificate to the contrary notwithstanding, the Corporation shall not, so long as any shares of the Preferred Stock remain outstanding, purchase shares of its Common Stock. A consolidation or merger of the Corporation or a sale or transfer of substantially all of its assets as an entirety, shall not be regarded as a voluntary liquidation, dissolution or winding up of the Corporation, or as a reduction of its capital.

(b) In the event of any involuntary liquidation dissolu-
43 tion or winding up of the Corporation, or any reduction of its capital, resulting in any distribution of its assets to

its stockholders, the holders of the Preferred Stock shall be entitled to receive, for each share thereof, out of the assets of the Corporation, whether from capital, surplus or earnings available for distribution to its stockholders, an amount equal to One hundred ($100) Dollars per share, together with an amount equal to all dividends accrued or in arrears thereon, whether or not earned, before any distribution of assets of the Corporation shall be made to the holder of the Common Stock; but the holders of Preferred Stock shall be entitled to no further participation in such distribution. If upon any such involuntary liquidation, dissolution, winding up or reduction, the assets of the Corporation, distributable as aforesaid among the holders of the Preferred Stock, shall be insufficient as to payment to them of the full preferential amounts aforesaid, then the entire net assets of the Corporation to be distributed shall be distributed ratably among the holders of the Preferred Stock in proportion to the full preferential amounts to which they are respectively entitled. As used herein, the expression "dividends accrued or in arrears" means, in respect of each share of the Preferred Stock an amount equal to Six Dollars ($6.00) Dollars per share per annum from the date from which dividends thereon became cumulative to the date as of which the computation is to be made, less the aggregate amount (without interest) of all dividends theretofore paid (or deemed to have been paid) thereon, or declared and set aside for payment in respect thereof. Nothing in this paragraph (2) (b) shall be deemed to prevent the purchase or redemption of Preferred Stock in any manner permitted by law or herein provided for; provided, however, that anything in this certificate to the contrary notwithstanding, the Corporation shall not, so long as any shares of the Preferred Stock remain outstanding, pur-
44 chase shares of its Common Stock. A consolidation or merger of the Corporation, or a sale or transfer of substantially all of its assets as an entirety, shall not be regarded as an involuntary liquidation, dissolution or winding up of the Corporation, or as a reduction of its capital.

(3) Redemption and Purchase: Upon at least thirty (30) days' notice given both by mail to the record holders of the shares of Preferred Stock to be redeemed and by publication in two newspapers of general circulation in the Borough of Manhattan, the City of New York, State of New York, the Corporation may redeem all or any part of the shares of Preferred Stock at the time outstanding, by lot or pro rata, on any semi-annual dividend payment date, at the price (herein called redemption price) of One hundred six and 50 100 ($106.50) Dollars, per share, plus dividends accrued or in arrears to the designated redemption date, all

by such method as shall be provided from time to time by resolution of the Board of Directors or by the Bylaws of the Corporation. From and after the date fixed in such notice as the date of redemption, unless default shall be made by the Corporation, in providing moneys at the time and place specified for the payment of the redemption price pursuant to such notice, all dividends on the Preferred Stock thereby called for redemption shall cease to accrue and all rights of the holders thereof as stockholders of the Corporation, except the right to receive the redemption price, shall cease and determine, and such shares shall be deemed no longer to be outstanding. No redemption of Preferred Stock as herein provided shall be made or ordered unless full cumulative dividends at the fixed rate hereinabove specified upon all of the Preferred Stock then outstanding, which is not be redeemed, from the date from which dividends thereon became cumulative to the end of the then current dividend period, shall have been paid or declared and a sum sufficient for the payment thereof set
45 apart. The Corporation may, also, from time to time, purchase shares of its Preferred Stock either through the Retirement Fund in the manner and subject to the terms as hereinafter provided for, or from any other funds available for such purpose and not exceeding the price at which the same may be redeemed. Shares of Preferred Stock redeemed, or in any manner purchased or acquired by the Corporation, whether through purchase upon conversion or otherwise, shall not be reissued by it, but shall be cancelled and retired in the manner permitted by law.

(4) Retirement or Sinking Fund: On or before the one hundred and twentieth (120th) day after the close of the Corporation's fiscal year ending in 1938, and on or before the corresponding day after the close of each fiscal year thereafter, so long as any shares of the Preferred Stock shall be outstanding, the Corporation shall set apart out of its net earnings, if any, of each fiscal year, for the purchase of its Preferred Stock, a sum sufficient to provide a fund (hereinafter sometimes called the Retirement Fund) equal to twelve and one-half ($12\frac{1}{2}\%$) per centum of the consolidated net earnings of the Corporation for such fiscal year after deducting therefrom an amount equal to the full cumulative dividend requirement for such year, at the fixed rates hereinabove specified, upon all shares of Preferred Stock then outstanding during such year. Said sum shall be set apart (a) only after full cumulative dividends on all of the Preferred Stock then outstanding, at the fixed rates hereinabove specified, from the date from which dividends thereon became cumulative to the end of the then current dividend period shall have been paid or declared and a sum sufficient for the payment thereof set apart and (b) in each instance before any dividends shall be declared

or paid upon or set apart for the Common Stock, or any
46 other distribution ordered or made in respect thereof. If the Corporation shall, in any year or years have consolidated net earnings but shall not for any reason set apart for the Retirement Fund a sum equal to twelve and one-half (12½%) per centum of such consolidated net earnings, if any, after deducting therefrom all cumulative Preferred Stock, dividend requirements, as above provided, the obligation of the Corporation to set apart such sum shall be cumulative so that, if the full amount required to be set apart as aforesaid in each such year for the Retirement Fund shall not be so set apart, the deficiency shall be made good before any dividends shall be declared or paid upon or set apart for the Common Stock, or any other distribution ordered or made in respect thereof. The amount so set apart for the Retirement Fund shall be applied from time to time by the Corporation, during the twelve months period following the date said amount is so set apart (whether on or prior or subsequent to the date above mentioned, to the purchase, directly or through agents, of Preferred Stock in the open market or at public or private sale, as the Corporation shall in its discretion determine, at the lowest price at which it may be offered but in no case at more than One hundred and six and 50/100 ($106.50) Dollars per share, but if no shares of Preferred Stock shall be offered for sale to the Corporation at or below the price of One hundred and six and 50/100 ($106.50) Dollars per share, the Board of Directors may, at their option, allow the Retirement Fund to accumulate, or they may use any portion or all of it for the purchase, in their discretion, of outstanding Preferred Stock by calling in such Preferred Stock for redemption at prices not exceeding the redemption price and in the manner and method set forth in paragraph (3) of Division "A" above; provided, however, that no
47 purchase of Preferred Stock may be made through the Retirement Fund if the Corporation is at the time in default in the payment of full cumulative dividends on its Preferred Stock; and provided, further, that said twelve month period shall be extended by such period of time as the Corporation shall be in default in the payment of full cumulative dividends on its Preferred Stock. In the handling of the Retirement Fund, the amount so set apart in respect of any fiscal year shall be segregated on the books of the Corporation from the amount so set apart in respect to any other fiscal year, and purchases of Preferred Stock, through such Fund shall be charged against unexpended balances of amounts so set apart and then in such fund in the order in which they were so set apart.

If the holder of any stock so called for redemption shall refuse or neglect to surrender the certificate for the same upon the ex-

piration of thirty (30) days' notice by mail to the holder of record, the Corporation may deposit the purchase price of the stock to the credit of such holder in any bank or trust company authorized to do business in the State of New York and upon such deposit made as aforesaid, and notice thereof mailed to the stockholder, his right to share in the future profits of the Corporation by way of dividends or otherwise, or to participate in any distribution of capital assets, shall cease and determine and he shall have no other or further right or recourse against the Corporation on account of such stock. Any moneys so deposited which shall remain unclaimed by the holders of such Preferred Stock, at the end of six (6) years after the redemption date, together with any interest thereon that shall have been allowed by the bank or trust company with which the deposit shall have been made, shall be paid by said bank or trust company to the Corporation.

(5) Restriction on certain corporate action: In addition
48 to any other provisions or consents required at the time by Statute, the Corporation shall not, without the affirmative vote of the holders of record of at least two-thirds ($\frac{2}{3}$) in interest of the Preferred Stock at the time outstanding, given in person or by proxy, at a special meeting called for the purpose, at which the Preferred Stock shall vote separately as a class:

(a) Authorize, create, or issue any new class of stock having any preference or priority which is or would be superior to or on an equality with any preference or priority of the Preferred Stock, provided herein; or authorize, create or issue any obligation or security convertible into or evidencing the right to purchase any stock having any such preference priority or equality; provided, however, that the provision of this subparagraph (a) shall not apply to the authorization, creation or issuance of additional shares of such Preferred Stock; or

(b) Issue any shares of Preferred Stock in excess of a total of Twenty-one thousand (21,000) shares, provided that such affirmative vote shall not be necessary for effecting or validating any such issue if the net earnings of the Corporation (and its subsidiaries, if any, upon a consolidated basis), plus the net earnings of the properties, if any, to be acquired by all or any part of the proposed issue of Preferred Stock or the proceeds thereof shall for a period of twelve (12) successive calendar months ending within the ninety (90) days immediately preceding such issue, amount to not less than two and one-half times, or shall for a period of twenty-four (24) successive calendar months ending within the ninety (90) days immediately preceding such issue, amount to five times the aggregate annual dividend requirements on the shares of Preferred Stock outstanding and those then proposed to be issued; or

(c) Amend this certificate by which the preferences of the Preferred Stock would be altered or changed; or

(d) Create any mortgage, lien, charge or encumbrance of any kind upon any part of the real or personal property of the Corporation or of any subsidiary, or the creation of any bonds, notes, or other evidences of indebtedness maturing more than eighteen months from the date of issue; provided, however, that this restriction shall not apply to:

I. The giving of purchase money mortgages or other purchase money liens on property that may hereafter be acquired by the Corporation or any subsidiary; or the renewal or refunding of such mortgages; or

II. The acquiring of property subject to mortgages, liens, charges or encumbrances thereon then existing; or the renewal or refunding of such mortgages; or

III. The pledging or otherwise encumbering by the Corporation or by any subsidiary, as security for loans made to it in the regular and current conduct of its business, of notes, accounts receivable, merchandise stocks, bonds or other securities or other liquid assets owned by it, other than obligations, securities or stocks of any subsidiary.

When under the provision of subparagraph (b) of this paragraph (5), the net earnings of the Corporation (and its subsidiaries, if any, upon a consolidated basis) are required to be computed for a stated period, and any properties have been acquired by the Corporation or its subsidiaries which were not owned by the Corporation or its subsidiaries during all or part of the period for which such computation is to be made, then and in every such case the net earnings of such properties during the entire period for which the computation is to be made shall be treated and considered as part of the net earnings of the Corporation for such period.

(6) Voting Power: Except as otherwise provided in this Certificate of Incorporation and any amendment or amendments thereto, or as otherwise required by law, the Preferred Stock shall have no right to vote for the election of directors or for any other purpose (including a proceeding for mortgaging the property and franchises of the Corporation, for guaranteeing the bonds of another corporation, for the sale of the franchises and property, for establishing priorities, or creating preferences among the several classes of stock, for consolidation, for voluntary dissolution, or for change of name), and shall not be entitled to receive notice of any meeting of stockholders, and all voting rights for the election of directors, except as herein provided for, and for author-

izing any corporate action whatsoever required to be authorized by the stockholders, and for all other purposes, shall be vested exclusively in the Common Stock, subject to whatever rights of voting otherwise given in this Certificate to the holders of Preferred Stock, provided, however, that if and whenever three semi-annual dividends on the Preferred Stock shall be unpaid in whole or in part, then the Preferred Stock shall be entitled to the exclusive voting rights for the election of directors, until all arrears in dividends on the Preferred Stock shall have been paid in full and the semi-annual dividend thereon for the current semi-annual dividend period shall have been declared and set apart in full (which shall be done as expeditiously as practicable), and thereupon the exclusive voting right for the election of directors shall be divested from the Preferred Stock and revested in the
51 Common Stock, subject, however, as long as Twenty-five per cent (25%) of the total authorized issue of Preferred Stock is issued and outstanding, to the right of the holders of said Preferred Stock to elect one-third of the members of the Board of Directors, provided, however, that if the total number of directors is not divisible by three, the number of the directors which the Preferred stockholders may by right elect shall be one-third of the number so divisible less than the total number of directors to be elected.

In any case where the Preferred Stock shall become vested with the exclusive voting right for the election of directors, a meeting of the Preferred stockholders shall forthwith be called, and at such meeting the Preferred stockholders may, by a vote of a majority of all the shares of Preferred Stock issued and outstanding, remove from office all directors then holding office and elect a new board of directors.

Similarly, in any case where the Common Stock shall become revested with the exclusive voting right for the election of directors, a meeting of the Common stockholders shall forthwith be called; and at such meeting the Common stockholders may, by a vote of a majority of all the shares of Common Stock outstanding, remove from office all directors then holding office and elect a new board of directors, subject to the rights of the holders of the Preferred Stock to elect a proportionate number of members of said board as hereinbefore set forth.

Each stockholder entitled to vote at any particular time in accordance with the foregoing provisions, shall have one vote for each share of the stock at the time entitled to voting rights held of record by him on the date fixed for determining voting rights.

52 DIVISION "B"—COMMON STOCK

(1) Dividends: After full cumulative dividends on the Preferred Stock shall have been paid or set apart for payment in accordance with paragraph (1) of Division "A" above and after there shall have been set apart an amount or amounts sufficient to provide for the Retirement Fund as required by paragraph (4) of Division "A" above, dividends may be declared and paid upon the Common Stock after January 1, 1937, if, when and as declared by the Board of Directors, out of the surplus or net earnings of the Corporation; provided that in determining the amount of such surplus there shall not be included:

(I) Surplus arising from an increase in the value of any assets, unless actually realized upon sale or other disposition thereof; or

(II) Surplus used for the purchase or the acquisition by the Corporation of shares of any class of its stock, other than Preferred Stock or created or growing out of the acquisition or redemption by the Corporation of shares of any other class of its stock; or

(III) Surplus arising from any change in par value, stated capital or capital attributable to its shares of stock of any class.

(2) Distribution of Assets: In the event of liquidation, dissolution, or winding up of the Corporation, or any reduction of its capital, resulting in a distribution of its assets to its stockholders, whether voluntary or involuntary, after there shall have been paid to, or set apart for the holders of the Preferred Stock the full preferential amount to which they are respectively entitled under the provisions of paragraphs (2) and (3)
53 of Division "A", above, the remaining net assets are to be distributed pro rata among holders of the Common Stock.

(3) Voting Power: Except as provided in paragraphs (5) and (6) of Division "A" above, the holders of the Common Stock shall possess full voting power for the election of Directors and for all other purposes.

DIVISION "C"—GENERAL PROVISIONS

(1) No holder of Preferred Stock and no holder of Common Stock shall be entitled, as such a matter of right, to subscribe for, or purchase any part of any new additional issue of Preferred Stock, or Common Stock, or any other class of stock whatsoever or of securities convertible into or evidencing the right to purchase any such class of stock, whether now or hereafter authorized, or whether issued for cash, property or services or otherwise, except

that no shares of Common Stock or of any new class of Common Stock and no securities convertible into or evidencing the right to purchase such stock shall be issued for money, without being offered for subscription pro rata to the holders of the outstanding Common Stock.

(2) All shares of Preferred Stock and Common Stock of the Corporation not to be outstanding after giving effect to the change or re-classification herein provided for shall be available for issuance by the Corporation in accordance with the statutes which in such case may provide.

(3) The phrase "consolidated net earnings of the Corporation" as used in this certificate shall be deemed to mean the net earnings of the Corporation and its subsidiaries for the fiscal year 54 in question, calculated on a consolidated basis in accordance with sound accounting practice, as shown by a statement duly certified or verified by an independent firm of certified public accountants or public accountants approved by the Board of Directors of the Corporation; and the term "subsidiary" or "subsidiaries" as used herein this certificate shall be deemed to mean any corporation or corporations not less than a majority of the outstanding stock of which having power to elect a majority of its Board of Directors (at all times or except in the event of default in the payment of dividends on any stock) shall at all times be owned by the Corporation and or any other subsidiary or subsidiaries.

(4) No fractional shares of the Preferred Stock or Common Stock shall be issued. If rights to fractions of shares of Preferred Stock or Common Stock result from such re-classification and change, the Corporation shall for each such fractional share, issue and deliver to each holder of the hereinbefore authorized 7% Cumulative Preferred or Preference Stock entitled thereto, a scrip certificate or certificates representing such fraction of a share, which, when surrendered with other similar scrip certificates within five years from December 31, 1936, shall entitle the bearer to receive from the Corporation in exchange therefor a certificate for the full number of shares called for by such scrip certificates in the aggregate. Such scrip certificates shall not entitle the bearer thereof to any dividends or voting rights or any other or different powers, rights or privileges of the stock of the Corporation and shall be void after five (5) years from December 31, 1936.

(5) All shares of whatever class of stock which may hereafter be issued by the Corporation shall be deemed "full paid and non-assessable" shares.

55 Tenth. The statements respecting its capital contained in the last certificate filed pursuant to law by said Corporation, are as follows:

The capital of the Corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value plus $5.00 in respect to every issued share without par value, plus such amounts as from time to time by resolution of the Board of Directors may be transferred thereto.

The Corporation may issue and sell its authorized shares without par value for such consideration as, from time to time, may be fixed by the Board of Directors. Any and all shares without par value so issued shall be deemed fully paid and nonassessable and the holder of such shares shall not be liable to the Corporation or to its creditors in respect thereto.

Eleventh. The amount of capital stock shall hereafter be One million six hundred fifth-three thousand four hundred twenty-four ($1,653,124.00) Dollars.

In witness whereof, we have made, subscribed and acknowledged this certificate this—day of—, 1936.

Further resolved, that when the amendment of the Certificate of Incorporation of the Company, as aforesaid, shall become effective the officers of the Corporation be, and they hereby are authorized and empowered to issue and deliver to the holders of 7% Cumulative Preferred or Preference Stock of record as of the close of business December 31, 1936, in exchange for each one share thereof, one and one-sixth shares of the fully paid and non-

56 assessable Cumulative Preferred Stock with a par value of Seventy-five ($75.00) Dollars per share, and one-half ($1/2) share of the One ($1.00) Dollar par value Common Stock and $15.08 in cash, in full liquidation, satisfaction and discharge of the 7% Cumulative Preferred or Preference Stock and all dividends accumulated and in arrears thereon, to and including December 31, 1936, and all other rights, preferences or claims thereon; and to issue and deliver to the holders of the no par value Common Stock of record as of the close of business December 31, 1936, in exchange for each one share thereof, one share of the Common Stock with a par value of One ($1.00) Dollar per share, in full liquidation, satisfaction and discharge of the no par value Common Stock and of all rights, preferences and claims thereon;

Further resolved, that the officers of the Company be, and they hereby are, authorized and empowered to sign such certificates, agreements and other documents as may be necessary, including changes, or modification in the foregoing amendment of the Cer-

tificate of Incorporation, as may be necessary and to affix the Corporation's seal to any and all thereof, and to take such other and further steps or action as may be deemed necessary to effectuate any or all of the foregoing;

Further resolved, that a Special Meeting of the stockholders of the Company be, and it hereby is called to be held at the principal and registered office of the Company at Madison Avenue and 45th Street, New York City, on December 8, 1936, at eleven o'clock A. M. for the purpose of considering and acting upon the foregoing resolution; that the Stock Transfer Books shall not be closed but that only stockholders of record at the close of business on November 18, 1936, shall be entitled to vote thereat or at any adjournment or adjournments thereof.

57 *Exhibit B, annexed to stipulation of facts*

ABERCROMBIE & FITCH COMPANY

MADISON AVENUE AT 45TH STREET

NEW YORK

DECEMBER 9, 1936.

To the Holders of Certificates for 7% Preferred or Preference Stock and Common Stock of Abercrombie & Fitch Company:

Announcement is hereby made to you that the plan of Recapitalization of your Company recently submitted to you was approved at the special meeting of the Stockholders in New York on December 8, 1936, by more than two-thirds majority of both Preferred or Preference and Common Stockholders.

The amendment to the Certificate of Incorporation approved at the meeting became effective on December 9th, 1936. A certificate for one share of the old Preferred or Preference Stock now entitles the holder thereof to certificates for one and one-sixth shares of the new Preferred Stock and one-half share of Common Stock and to a cash payment of $15.08 per share.

A certificate for one share of the old no par value Common Stock now entitles the holder thereof to a certificate for one share of the new par value Common Stock.

Certificates for the new shares can be delivered and the cash payment of $15.08 per share of the old Preferred or Preference Stock can be made only upon surrender and cancellation of cer-

tificates for the old Preferred or Preference Stock. Likewise, certificates for the new shares of the par value Common Stock can be delivered only upon surrender and cancellation of certificates for the old no par value Common Stock. The exchange of certificates and the cash payment will be effected for the Company by the Irving Trust Company, Agent, Corporate Trust Department, 1 Wall Street, New York City, N. Y., to which the stockholders are requested to send their certificates for old Preferred or Preference Stock, or the Old Common Stock. The new certificates will be delivered on or about January 15, 1937, at which time the cash payment of $15.08 per share will also be made.

All certificates for the old Preferred or Preference Stock and Common Stock should be accompanied by the Letter of Transmittal attached hereto, filled out in accordance with the instructions thereon.

As provided by the amendment to the Company's certificate of Incorporation, no certificates for fractions of a share of the new Preferred and Common Stock will be issued. Stockholders will receive scrip certificates for fractions of shares, and the Company will assist the holders thereof in rounding out their holdings into full shares. Scrip certificates calling in the aggregate for any number of full shares may be exchanged for full share certificates at the office of the Irving Trust Company, Corporate Trust Department, 1 Wall Street, New York City, N. Y., mentioned above at any time on or before January 15, 1941.

I wish to take this opportunity to thank the Stockholders for their prompt and enthusiastic support of the Plan of Recapitalization submitted to them. The position of the Company in the trade and with its customers I feel will be greatly improved by this step, and you may rest assured that all the energies of the management are being devoted in every way toward further improvement of the profits.

Respectfully yours,

J. S. COBB, *President.*

Exhibit C, annexed to stipulation of facts

ABERCROMBIE & FITCH COMPANY

SUMMARY OF SURPLUS ACCOUNT

For the Period from January 1, 1913 to January 31, 1936

Balance, January 1, 1913		$8,170.25
Credits:		
Net income	$2,443,123.50	
Reserves restored to surplus including adjustments of accounts receivable reserves	225,880.87	
Sinking fund redemption of preferred stock of Abercrombie and Fitch Company below par	14,900.00	
Other:		
Value of common stock of the Abercrombie and Fitch Company donated to the Company	12,900.00	
Excess of sale price of original issue of capital stock of Abercrombie and Fitch Company, sold in 1929 and 1930, over par value of said stock	53,169.70	
Cancellation of indebtedness to subsidiary company	21,225.21	
Proceeds of life insurance policy—net	35,082.50	
Miscellaneous adjustments for taxes, bad debt reserves, etc	25,383.96	2,831,659.54
Total credits		$2,839,829.79
Debits:		
Cash dividends	$1,208,325.05	
Common stock dividends paid in common stock on April 30, 1920	$161,700.00	
Common stock dividends paid in preferred stock:		
February 20, 1928	323,400.00	
January 21, 1930	359,000.00	844,100.00
Reserves	168,745.03	
Goodwill written off	27,383.80	
Investments in subsidiary real estate companies written off	839,826.61	
Miscellaneous—additional taxes, commissions, etc	451,221.17	3,239,601.66
Balance, January 31, 1936		$399,771.87

(Figures in italics were red in original.)

61 In the Tax Court of the United States

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 107302. Promulgated January 26, 1943.

Cash distributed as part of a tax-free exchange of stock under section 112 (b) (3) of the Revenue Act of 1936 pursuant to a plan of recapitalization held taxable as a dividend under section 112 (c) (2) where the corporation, disregarding charges to surplus account upon the issuance of nontaxable stock dividends in prior years (see section 115 (b)), had sufficient earnings and profits accumulated since February 28, 1913, to cover the cash distribution.

H. S. McKinney, Esq., for the petitioner.
H. C. Clark, Esq., for the respondent.

Opinion

ARUNDELL, Judge: The Commissioner determined an income tax deficiency for the calendar year 1937 in the amount of $13,887.24. The sole issue is whether cash of $45,240 received by petitioner pursuant to a plan of recapitalization is taxable as a dividend, as determined by respondent, or as capital gain to the extent of 40 percent thereof, as reported by petitioner. The material facts are stipulated and may be briefly summarized.

Petitioner is the executor of the estate of Edward T. Bedford, who died May 21, 1931. Its income tax return for 1937 was filed with the collector for the second district of New York.

62 In 1937 petitioner owned 3,000 shares of 7 percent cumulative preferred stock of the Abercrombie & Fitch Co., having a par value of $100 per share. The stock had been owned by Bedford at the time of his death and at that time it had a fair market value of $210,000. In accordance with a plan of recapitalization duly approved by the directors and stockholders of the Abercrombie & Fitch Co., petitioner in January 1937 exchanged its 3,000 shares of 7 percent cumulative preferred stock for 3,500 shares of $6 cumulative preferred stock with a par value of $75, 1,500 shares of common stock, and cash in the amount of $45,240. The fair market value of the securities and cash received by petitioner under said plan was $349,740. The number of shares of 7

7 percent cumulative preferred stock outstanding at the time of the recapitalization was 17,973. The cash payable to the holders of such shares upon the exchange was at the rate of $15.08 per share, or a total on the outstanding shares of $271,032.84.

On January 31, 1936, the surplus account on the books of the Abercrombie & Fitch Co., showed a deficit of $399,771.87, after the deduction of three stock dividends. There had been charged to surplus account the following amounts upon the issuance of stock dividends: $161,700 on April 30, 1920, upon the issuance of a common stock dividend paid in common stock; and the amounts of $323,400, and $[illegible] upon the issuance on February 20, 1928, and January 21, 1930, respectively, of common stock dividends paid in preferred stock. The company's surplus account on January 1, 1913, had a balance of $8,170.25. For its fiscal year ended January 31, 1937, the company had net earnings of $309,073.70 after taxes.

The parties are agreed that the exchange of stock for stock pursuant to the plan of recapitalization was a nontaxable transaction under section 112 (b) (3) of the Revenue Act of 1936. Petitioner concedes that gain in excess of the amount of cash received was realized upon the exchange and that, therefore, the cash is to be "recognized" as taxable gain under the provisions of section 112 (c) as "other property or money." It maintains, however, that subdivision (1) of section 112 (c) governs; that consequently the recognized gain is taxable as a capital gain, limited by the provisions of section 117 (a). Respondent takes the view, and has so determined, that the distribution of the cash had "the effect of the distribution of a taxable dividend," and as such is to be taxed as a dividend under the plain language of subdivision (2) of section 112 (c). The material provisions of the statute are set forth below.[1]

63

[1] SEC. 112. RECOGNITION OF GAIN OR LOSS.

(b) EXCHANGES SOLELY IN KIND.—

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(c) GAIN FROM EXCHANGES NOT SOLELY IN KIND.

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

Petitioner has failed to demonstrate any error in the Commissioner's determination. Its principal position is
64 that the cash distributed did not have the effect of a taxable dividend because the distributing corporation had no earnings or profits accumulated since February 28, 1913, with which to pay dividends. While it is true that the books showed a deficit on January 31, 1936, of nearly $400,000, it is undisputed that the amount of $844,100 had been charged to earnings upon the issuance of stock dividends in prior years. Since these dividends were tax-free, the first one under the rule of Eisner v. Macomber, 252 U. S. 189, and the last two under the revenue act in force when they were made,[1] they do not serve to reduce earnings and profits available for future distribution. There were thus earnings and profits in January 1937 greatly in excess of the cash payment connected with the recapitalization.

Petitioner argues with respect to two of the stock dividends, which took the form of preferred stock on common stock, that the distributions constituted income under the Sixteenth Amendment, Koshland v. Helvering, 298 U. S. 441, Helvering v. Gowran, 302 U. S. 238, and that, therefore, they were distributions of earnings and profits, even though the revenue act then in force saw fit to exempt them from tax. This argument completely overlooks section 115 (h) of the Revenue Act of 1936, which provides as follows:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * * * *

(h) EFFECT ON EARNINGS AND PROFITS OF DISTRIBUTIONS OF STOCK.—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in
65 another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

This section is merely an enactment of what the law had been for many years prior to 1936. Senate Rept. 2156, 74th Cong., 2d sess., p. 19; August Horrmann, 34 B. T. A. 1178, 1184; F. J. Young Cor-

[1] Revenue Act of 1928, sec. 115 (f):
(f) STOCK DIVIDENDS.—A stock dividend shall not be subject to tax.

poration, 35 B. T. A. 860; affd., 103 Fed. (2d) 137; Mertens Law of Federal Income Taxation, vol. 1, § 9.47; John K. Bretta, 1 T. C. 86.

Petitioner also appears to argue that there was a mere exchange pursuant to a plan of recapitalization and that cash distributed in an exchange can not be treated as a dividend, citing Humphreys Manufacturing Co., 45 B. T. A. 114. But section 112 (c) (2) applies by its terms not to distributions which take the form of a dividend, but to any distribution which has the effect of the distribution of a taxable dividend. It contemplates the very situation under consideration, for it is applicable only if a distribution falls first within section 112 (c) (1), and a transaction falls within that subdivision only if it is part of "an exchange * * * within the provisions of subsection (b) (1), (2), (3), or (5) of this section." In other words, the statute itself requires that a distribution of cash or property in connection with an
66 exchange of stock for stock to be taxed as a dividend if it has that effect.[1] We think the distribution under consideration clearly falls within section 112 (c) (2). Love v. Commissioner, 113 Fed. (2d) 236; J. T. Owens, 27 B. T. A. 469, 474; affd., 69 Fed. (2d) 597. The case relied upon by petitioner, Humphreys Manufacturing Co., supra, was decided on a failure of proof. It followed J. Weingarten, Inc., 44 B. T. A. 788, 809, which recognized that cash distributed under similar circumstances had the effect of the distribution of a dividend. To the same effect is the more recent case of Knapp Monarch Co., 1 T. C. 59.

67 Petitioner's final argument, as we understand it, is that the cash payment should not be treated as a dividend, because the company had a book deficit and was thereby prohibited by state law from declaring dividends. Petitioner contends that an ordinary dividend would not and could not be declared, and it is urged that it would be improper to regard a dis-

[1] Section 112 (c) (2) had its origin in section 203 (d) (2) of the 1924 Act. Its purpose, as stated in House Report 179, 68th Cong., 1st sess., pp. 14, 15, as follows:

"(2) There is no provision of the existing law which corresponds to paragraph (2) of subdivision (d). This subdivision provides that any amount distributed by a corporation in connection with a reorganization which has the effect of a taxable dividend shall be taxed as a dividend and not as a taxable gain.

"The necessity for this provision may best be shown by an example: Corporation A has capital stock of $1,000,000, and earnings and profits accumulated since March 1, 1913, of $500,000. If it distributes the $500,000 as a dividend to its stockholders, the amount distributed will be taxed at the full surtax rates.

"On the other hand, Corporation A may organize Corporation B, to which it transfers all its assets, the consideration for the transfer being the issuance by B of all its stock and $500,000 in cash to the stockholders of Corporation A in exchange for their stock in Corporation A. Under the existing law, the $500,000 distributed with the stock of Corporation B would be taxed, not as a dividend, but as a capital gain, subject only to 12½ per cent rate. The effect of such a distribution is obviously the same as if the corporation had declared out as a dividend its $500,000 earnings and profits. If dividends are to be subject to the full surtax rates, then such an amount so distributed should also be subject to the surtax rates and not to the 12½ per cent rate on capital gain. Here again this provision prevents evasions."

tribution made in connection with a reorganization as a dividend when under state law a dividend could not legally be declared. The answer to this argument is plain. The revenue act has its own definition of a dividend. The corporation, for purposes of Federal income taxation, had a substantial surplus rather than a deficit; any distribution by a corporation having earnings or profits is presumed by section 115 (b), for the purposes of Federal income taxation, to have been out of those earnings or profits; and any such distribution is declared by section 115 (a) to be a dividend. In the instant case the corporation had a surplus in the eyes of the revenue act and there was a distribution of cash among its shareholders. The distribution did not take the form of an ordinary dividend, governed by section 115 (a) and (b), but its effect was precisely the same. It, therefore, falls within the express and unambiguous language of section 112 (c) (2).

The Commissioner is sustained in his determination.

Decision will be entered for respondent.

68 In the Tax Court of the United States

Decision

Pursuant to the determination of the Court, as set forth in its Opinion, promulgated January 26, 1943, it is

Ordered and decided: That there is a deficiency in income tax of $13,887.24 for the calendar year 1937.

Enter:

Entered January 27, 1943.

(S) J. E. MURDOCK, *Judge.*

In United States Circuit Court of Appeals, Second Circuit

Petition for review and assignments of error

To the Honorable, Judges of the United States Circuit Court of Appeals for the Second Circuit:

Your petitioner, Estate of Edward T. Bedford, Title Guarantee and Trust Company, Executor, by its attorney, Holt S. McKinney, hereby files its petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of The Tax Court of the United States entered January 27, 1943, determining a deficiency in federal income tax of your petitioner for the year 1937 in the amount of $13,887.24, and respectfully shows:

69

JURISDICTION AND VENUE

This petition is filed pursuant to the provisions of sections 1141 and 1142 of the Internal Revenue Code.

Your petitioner is the Executor of the Last Will and Testament of Edward T. Bedford and is a corporation organized and existing under the laws of the State of New York with its principal office at 176 Broadway, Borough of Manhattan, City and State of New York. The federal income tax return for the estate of the said Edward T. Bedford for the year 1937, which is the return of the tax in respect of which the liability involved herein arises, was made to the Office of the Collector of Internal Revenue of the United States for the Second District of New York, which is located in New York, New York, and within the judicial circuit of the United States Circuit Court of Appeals for the Second Circuit.

The respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States holding his office by virtue of the laws of the United States.

II

NATURE OF THE CONTROVERSY

The sole issue presented by the petition for review is whether the cash payment of $45,240 received by petitioner in 1937 from the reorganization of the Abercrombie & Fitch Company had "the effect of the distribution of a taxable dividend." The petitioner contends that this $45,240 cash amount, in respect of which The Tax Court determined the deficiency in tax, constituted a gain from exchange, taxable as a capital gain in accordance with the provisions of sections 112 (c) (1) and 117 (a) of the Revenue Act of 1936, but the respondent contends that it is taxable as a dividend under section 112 (c) (2) of the Revenue Act of 1936.

In the early years of the depression the Abercrombie & Fitch Company incurred heavy losses, as a result of which it had an accumulated deficit in its surplus account per books on January 31, 1936 of $599,771.87.

Due to the existence of this deficit, the president of Abercrombie & Fitch Company felt that its position in the trade and with its customers was being affected. The company had been unable for over five years to pay any dividend on either its preferred or common stocks. Accordingly, a "Plan of Recapitalization" of the company was proposed and submitted to stockholders for their

consideration and approval. This plan was approved by the stockholders of the Abercrombie & Fitch Company at a Special meeting called for that purpose and held on December 8, 1936. This "Plan of Recapitalization" had the following four-fold business purpose:

To enable the Abercrombie & Fitch Company to eliminate the surplus deficit on its books.

To prepare the way for the resumption of dividend payments on its stock.

To eliminate the accumulated arrears of dividends on its 7% cumulative preferred stock.

To improve the position of the company in the trade and with its customers.

At the time this recapitalization plan became effective, your petitioner owned 3,000 shares of 7% cumulative preferred stock (par value $100 per share) of the Abercrombie & Fitch Company, which shares of stock had been acquired by the said Edward T. Bedford prior to his death and were owned by him at the time of his death. Edward T. Bedford died on May 21, 1931 and the fair market value on that date of said 3,000 shares of 7% cumulative preferred stock of Abercrombie & Fitch Company was $210,000.

In accordance with the "Plan of Recapitalization" duly approved at a special meeting of the stockholders of Abercrombie & Fitch Company held on December 8, 1936, your petitioner exchanged its 3,000 shares of 7% cumulative preferred stock (par value $100 per share) in January 1937 for 3,500 shares of $6 cumulative preferred stock (par value $75 per share), 1,500 shares of common stock (par value $1 per share), and cash in the amount of $45,240. The fair market value of the securities and cash received by petitioner under said plan was $349,740. The number of shares of 7% cumulative preferred stock outstanding at the time of the recapitalization was 17,973. The cash payable to the holders of such shares upon the exchange was at the rate of $2.508 per share, or a total on the outstanding shares of $271,032.84.

From 1920 to 1930 inclusive, Abercrombie & Fitch Company declared and paid three stock dividends, upon the issuance of which its surplus account had been charged as follows: $161,700 on April 30, 1920, upon the issuance of a common stock dividend paid in common stock; and the amounts of $323,400 and $359,000 upon the issuance on February 20, 1928, and January 21, 1930, respectively, of common stock dividends paid in preferred stock. Though the above stock dividends were duly declared and paid out of surplus, the respondent herein contends that in determining the "effect" under section 112 (c) (2) of the Revenue Act of 1936 of the cash amount ($45,240) received by the petitioner from the

reorganization of Abercrombie & Fitch Company in 1937,
72 these stock dividends must be treated as restored to surplus account, because of the provisions of section 115 (h) of the Revenue Act of 1936. The Tax Court, contrary to your petitioner's contentions, sustained the respondent's determination and held that though the Abercrombie & Fitch Company had a surplus deficit, per books, at the time of the reorganization and could not have lawfully paid a dividend, nevertheless for the purpose of federal income tax, the cash of $45,240 which the petitioner received had "the effect of the distribution of a taxable dividend" within the meaning of section 112 (c) (2) of the Revenue Act of 1936. For its fiscal year ended January 31, 1937, the Abercrombie & Fitch Company had net earnings after taxes of $309,073.70.

III

Designation of Court of Review

Your petitioner, being aggrieved by the proceedings, findings of fact, opinion and decision of The Tax Court of the United States, requests a review thereof by the United States Court of Appeals for the Second Circuit. The jurisdiction and venue of this Court is shown in section I of this petition for review.

IV

Assignments of Error

Your petitioner avers that The Tax Court of the United States committed the following errors to the prejudice of your petitioner: The Tax Court of the United States erred:

1. In ordering and deciding that there is a deficiency
73 in income tax of your petitioner for the year 1937 in the amount of $13,887.24.

2. In failing to order and decide that there is no deficiency in income tax of your petitioner for the year 1937.

3. In holding that the receipt by your petitioner in 1937 of cash in the amount of $45,240, as a result of the exchange of its stock in the Abercrombie & Fitch Company pursuant to the "Plan of Recapitalization" approved by the stockholders of that company on December 8, 1936, had "the effect of the distribution of a taxable dividend."

4. In failing to find and hold that the Abercrombie & Fitch Company at the time of its reorganization in 1937 had a surplus deficit and therefore could not have distributed a taxable dividend.

5. In holding that the provisions of section 115 (h) of the Revenue Act of 1936 were controlling in determining the "effect" of the receipt by your petitioner in 1937 of cash of $45,240 due to the reorganization of Abercrombie & Fitch Company.

6. In holding that the provisions of section 112 (c) (2) of the Revenue Act of 1936 should be applied in determining your petitioner's taxable income from the reorganization of the Abercrombie & Fitch Company in 1937.

7. In failing to hold that your petitioner's taxable income from the reorganization of the Abercrombie & Fitch Company in 1937 should be determined in accordance with the provisions of sections 112 (c) (1) and 117 (a) of the Revenue Act of 1936.

74 8. In that its opinion and decision are not supported by the evidence and are contrary to law.

Wherefore, your petitioner prays that the decision of The Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Second Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said Court and be transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors herein complained of may be reviewed and corrected.

HOLT S. MCKINNEY,
Holt S. McKinney,
Attorney for the Petitioner,
122 East 42nd Street, New York, N. Y.

(Verified April 21, 1943.)

75 In the United States Circuit Court of Appeals

Notice of filing petition for review

TO:

COMMISSIONER OF INTERNAL REVENUE, *Respondent,*
Internal Revenue Building, Washington, D. C.
and
J. P. WENCHEL, *Chief Counsel, Bureau of Internal Revenue,*
Attorney for Respondent,
Internal Revenue Building, Washington, D. C.

You are hereby notified that the above-named petitioner, Estate of Edward T. Bedford, Title Guarantee and Trust Company, Executor, did, on the 26th day of April 1943 file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the Tax Court heretofore

rendered in the above-entitled proceeding. Copy of the petition for review and the assignments of error, as filed, is hereto attached and served upon you.

Dated, New York, N. Y., April 22, 1943.

HOLT S. MCKINNEY,
Holt S. McKinney,
Attorney for the Petitioner,
122 East 42nd Street, New York, New York.

Service of the foregoing notice upon the respondent and
76 his attorney, together with a copy of the petition for review, and assignments of error described therein, is hereby admitted this 26th day of April, 1943.

(S) J. P. WENCHEL.
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue,
Attorney for the Respondent.

In The Tax Court of the United States

Praecipe for transcript of record

To the Clerk of The Tax Court of the United States:

You are hereby requested to prepare, certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, with reference to the petition for review heretofore filed in the above-entitled cause, a transcript of the record in said cause, prepared and transmitted as required by law and by the rules of said Court, and to include in said transcript of record duly certified copies of the following:

(1) Docket entries.
(2) Pleadings:
(a) Petition with annexed copy of deficiency letter.
(b) Answer.
(3) Motion of petitioner to amend the caption of the above proceeding.
(4) Order of the Board of Tax Appeals (now The Tax
77 Court of the United States) dated June 3, 1941, adopting the amended caption as prayed for in the above-mentioned motion of petitioner.
(5) Stipulation of Facts including Exhibits A, B, and C attached thereto.
(6) Opinion and Decision of The Tax Court.
(7) Petition for Review.

(8) Notice of filing Petition for Review, together with proof of service.

(9) This praecipe.

(10) Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record. (Not included in the record.)

HOLT S. MCKINNEY,
Holt S. McKinney,
Counsel for the Petitioner,
122 East 42nd Street, New York, New York.
J. P. WENCHEL,
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue,
Counsel for the Respondent.

78 [Clerk's certificate to foregoing transcript omitted in printing.]

79 In United States Circuit Court of Appeals for the Second Circuit

No. 93—October Term, 1943

(Argued January 6, 1944. Decided August 8, 1944.)

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Before L. HAND, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

Petition by Title Guarantee and Trust Company, Executor of the Will of Edward T. Bedford, deceased, to review an order of the Tax Court of the United States determining a deficiency of $13,887.24 on the part of the Estate of Edward T. Bedford in income taxes for the calendar year 1937. Reversed.

80 Holt S. McKinney, Attorney for Petitioner; Erwin R. Griswold and Holt S. McKinney, Counsel.

Samuel O. Clark, Jr., Assistant Attorney General, Sewall Key and Helen Goodner, Special Assistants to the Attorney General, for Respondent.

Opinion

AUGUSTUS N. HAND, Circuit Judge:

This appeal involves income taxes of the Estate of Edward T. Bedford, deceased, for 1937, in the amount of $13,887.24, and is taken from a decision of the United States Tax Court sustaining the assessment of the Commissioner of Internal Revenue. We think the decision of the Tax Court adjudging a deficiency of $13,887.24 should be reversed.

Edward T. Bedford died on May 21, 1931, and Title Guarantee and Trust Company is the executor of his estate and the taxpayer in this proceeding. Among his assets were 3,000 shares of 7% cumulative preferred stock of Abercrombie and Fitch Company (par value $100 per share) having a fair market value at the date of his death of $210,000. Because of business conditions prevailing in the years following Bedford's death Abercrombie and Fitch Company incurred losses, with the result that its surplus account showed a cumulative deficit of $399,771.87 on January 31, 1936. Included in charges against its surplus were amounts aggregating $844,100 which had been capitalized by three stock dividends issued in 1929, 1928, and 1930. Because of the deficit occasioned in the surplus account the Company had been unable for over five years to pay dividends on either its preferred or common stock. Accordingly a plan of recapitalization was 81 proposed and submitted to the stockholders for their consideration and approval and was adopted by them at a meeting held on December 8, 1936, and thereafter put into effect.

In accordance with this plan, the executor of Bedford received in January 1937, in exchange for its 3,000 shares of 7% cumulative preferred stock ($100 par value) the following:

	Fair market value
3,500 shares new Cumulative Preferred Stock of the Abercrombie and Fitch Company of a par value of $75 per share and an annual dividend of $6 per share	$288,750
1,500 shares of the Common Stock of the Abercrombie and Fitch Company of a par value of $1 per share	15,750
Cash of $15.08 per share	45,240
Total Fair Market Value	349,740

Abercrombie and Fitch Company had net earning after taxes during the taxable year ended January 31, 1937, of $309,073.70.

The stock received by the executor of Bedford in exchange for his former holdings was not subject to taxation because it was received through a reorganization and under the provisions of Section 112 (b) (3) of the Revenue Act:

"No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in

such corporation or in another corporation a party to the reorganization."

82 There concededly was a recognizable gain to the recipient to the extent of the cash distribution of $45,240 in so far as this cash and the securities received together exceeded the fair value of the shares the decedent held at the time of his death. This is so because of the provisions of Section 112 (c) (1) that in the case of money so distributed "gain * * * to the recipient shall be recognized but in an amount not in excess of the sum of such money and the fair market value of such other property."

It appears from the facts we have stated that the value of the stock Bedford held at the time of his death was $210,000 and the fair value of the securities and cash received through the reorganization was $349,740. Accordingly the gain amounted to $139,740 and the $45,240 of cash was taxable as a part of such gain if Section 112 (b) (3) should be applied. This, as we understand it, all parties concede. But the Commissioner held and successfully contended before the Tax Court that the cash distribution in pursuance of the plan of reorganization had "the effect of a distribution of a taxable dividend" and, therefore, subdivision 2 of Section 112 (c) (2), and not 112 (c) (1), applied. Section 112 (c) (2) provides that where such a distribution "has the effect of the distribution of a taxable dividend there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess on his ratable share of the undistributed earnings and profits of the corporation cumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property."

We held in Commissioner v. Quackenbos, 78 F. (2d) 156; Patty v. Helvering, 98 F. (2d) 717, and DeNobili Cigar Company v. Commissioner, decided June 20, 1944, that when earnings are once capitalized by the issue of stock dividends they are no longer

83 earnings but capital, except in cases where the purpose of the transaction is not an honest business purpose but one to avoid taxation. Under those decisions the distribution here was a liquidating dividend and not an ordinary dividend. The slight verbal changes in the provisions of Section 112 (c) (2) and Section 115 (g) seem to us the equivalent of provisions of prior Revenue Acts. We think our decisions are reasonable interpretations of the purpose of the statute and see no just ground for distinguishing between capital raised by the issue of stock dividends and that obtained through subscriptions pro tanto by the shareholders. Here the purpose of the issue of the stock dividends was to add to the capital and the object of the later reduction of the capital stock

through the reorganization was to enable the company to resume the payment of dividends when under the state law they could not be paid because the deficit had wiped out the surplus.

But even if the distributions here, according to the theory of the Commissioner and the Tax Court, might have been taken out of accumulated earnings, these distributions should have been charged to capital rather than surplus. In Foster v. United States, 303 U. S. 118, the Supreme Court held that where a corporation had made distributions in redemption of part of its stock they were to be considered distributions in partial liquidation chargeable to capital account and not distributions of surplus. See also Hellmich v. Hellman, 276 U. S. 233, 237.

The distribution here was a "partial liquidation" because all of the old stock of a par value of $300,000 was surrendered by the decedent for new stock having a par value of only $264,000. The transaction was evidently a distribution by Abercrombie and Fitch Company "in complete cancellation or redemption of a part of its stock." Such a distribution is a partial distribution as defined in Section 115 (i) of the Revenue Act. Hammans v. Commissioner, 121 F. (2d), 4, 7.

The order of the Tax Court is reversed.

United States Circuit Court of Appeals, Second Circuit

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 29th day of August, one thousand nine hundred and forty-four. Present: Hon. Learned Hand, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges. Estate of Edward T. Bedford, Title Guarantee & Trust Company, Petitioner v. Commissioner of Internal Revenue, Respondent. Appeal from The Tax Court of the United States.

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

ALEXANDER M. BELL,
Clerk.

By A. DANIEL FUSARO,
Deputy Clerk.

85 United States Circuit Court of Appeals, Second Circuit. Estate of Edward T. Bedford etc., v. Commissioner of Internal Revenue. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Aug. 29, 1944. Alexander M. Bell, Clerk.

86 [Clerk's certificate to foregoing transcript omitted in printing.]

87 Supreme Court of the United States.

Order allowing certiorari.

Filed January 8, 1945.

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. Counsel are requested to discuss in their briefs and on oral argument the question whether the application for certiorari was filed within the time provided by law.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] Enter The Attorney General. File No. 49163. U. S. Circuit Court of Appeals, Second Circuit. Term No. 710. Commissioner of Internal Revenue, Petitioner, vs. Estate of Edward T. Bedford, Title Guarantee and Trust Company, Executors. Petition for writ of certiorari and exhibit thereto. Filed November 29, 1944. Term No. 710 O. T. 1944.

GOVERNMENT PRINTING OFFICE 1945

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. ——

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in this case.

OPINIONS BELOW

The opinion of the Tax Court (R. 61–67) is reported at 1 T. C. 478. The opinion of the Circuit Court of Appeals (R. 79–81) is reported at 144 F. 2d 272.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 29, 1944. (R. 81–82.)

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the cash received in an exchange in connection with a reorganization was paid out of earnings and had the effect of a taxable dividend, so that it is to be taxed as a dividend within the meaning of Section 112 (c) (2) of the Revenue Act of 1936.

STATUTE AND REGULATIONS INVOLVED

The applicable statutes and regulations are printed in the Appendix, *infra*, pp. 16–22.

STATEMENT

The following are the relevant facts as stipulated (R. 14–60) and as stated by the Tax Court (R. 61–62):

Edward T. Bedford died on May 21, 1931. The Title Guarantee & Trust Company is the executor of his estate. (R. 14, 61.)

Among Bedford's assets were 3,000 shares of 7% cumulative preferred stock, par value $100, of Abercrombie & Fitch Company, which had a fair market value on the date of his death of $210,000. In January, 1937, pursuant to a plan of recapitalization of Abercrombie & Fitch Company, the executor exchanged the 3,000 shares of 7% preferred stock for 3,500 shares of 6% cumulative preferred stock, par value $75, 1,500 shares

of common stock, par value $1, and a cash distribution of $45,240 paid at the rate of $15.08 on each of the old preferred shares. The stock and cash so received had a fair market value of $349,740 and the gain on the exchange was $139,740. (R. 14–15, 61–62.)

On January 31, 1936, the books of Abercrombie & Fitch Company showed a deficit in surplus account of $399,771.87, after deduction of three stock dividends totaling $844,100, paid in 1920, 1928, and 1930.[1] For its fiscal year ended January 31, 1937, the company had net earnings of $309,073.70 after taxes. (R. 16, 59–60, 62.)

The parties agreed before the Tax Court that the recapitalization of Abercrombie & Fitch Company constituted a reorganization as defined in Section 112 (g) of the Revenue Act of 1936;[2] and that the gain of $139,740 on the exchange of old stock for new stock and cash was recognized for tax purposes only to the extent of the cash received, or $45,240, under the provisions of Section 112 (b) (3) and (c) (1). The taxpayer contended, however, that the cash distribution represented a capital gain, only 40% of which was taxable under the provisions of Section 117 (a).

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[1] These stock dividends were all non-taxable to the distributees, as will be shown, *infra*.

[2] Subsequent references are to the Revenue Act of 1936 unless otherwise indicated. All the sections of the Revenue Act of 1936 referred to in the petition will be found in the Appendix, *infra*.

The Commissioner determined that the cash distribution had the effect of a taxable dividend and was to be taxed as a dividend, as provided in Section 112 (c) (2). (R. 9, 62–63.)

The Tax Court held (R. 61–67) that the distribution of $45,240 in cash was made out of the accumulated earnings and profits of Abercrombie & Fitch Company and therefore had the effect of a taxable dividend, even though it was not in form a dividend. It therefore sustained the Commissioner's determination that the cash distribution was taxable as a dividend under the provisions of Section 112 (c) (2).

The Circuit Court of Appeals reversed (R. 79–81), holding, first, that the Abercrombie & Fitch Company had no accumulated earnings and profits out of which the cash distribution of $45,240 might have been taken because certain stock dividends which had been paid in prior years had converted the earnings into capital; second, that the distribution was not governed by Section 112 (c) (2), but was instead a liquidating dividend governed by Section 115; and, third, that the distribution was properly chargeable to capital account, even though the company may have had accumulated earnings.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that earlier non-taxable stock dividends had converted earnings into capital with

the consequence that the Abercrombie & Fitch Company had no undistributed earnings in the taxable year.

2. In holding that the cash distribution did not have the effect of a taxable dividend because Section 115 (g) should be read as a gloss upon Section 112 (c) (2).

3. In holding that the distribution was governed by Section 115 instead of 112 (c) (2) and hence was a liquidating dividend.

4. In holding that, as a part of a liquidating dividend, the cash distribution is properly chargeable to capital account.

REASONS FOR GRANTING THE WRIT

In reaching its conclusions the court below made several rulings which create conflicts with other decisions and which will cause confusion in the administration of the revenue laws.

1. The decision of the court below (R. 81) that the three stock dividends issued by Abercrombie & Fitch Company in 1920, 1928, and 1930 *pro tanto* converted earnings into capital is directly contrary to Section 115 (h) which provides in substance that the distribution of non-taxable stock dividends shall *not* be considered as distributions of earnings or profits. This means, of course, that the earnings are not affected by the stock dividends, but remain available for future distribution. Section 115 (h) was specifically

called to the attention of the court below, which ignored it completely.

There is no dispute that the three stock dividends were non-taxable and that there were sufficient earnings to cover the cash distribution if the stock dividends may not be capitalized.[3]

The decision that the non-taxable stock dividends had the effect of capitalizing earnings for tax purposes is also in direct conflict with *Beretta v. Commissioner*, 141 F. 2d 452 (C. C. A. 5th),[4]

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[3] The stock dividend of $161,700 issued in 1920 was paid in common stock on common (R. 60) and was nontaxable because it did not constitute income within the meaning of the Sixteenth Amendment under the rule of *Eisner* v. *Macomber*, 252 U. S. 189, and *Helvering* v. *Griffiths*, 318 U. S. 371. The stock dividends of $323,400 and $359,000 issued in 1928 and 1930, respectively, were paid in preferred stock on common (R. 60) and were nontaxable under the provisions of Section 115 (f) of the Revenue Act of 1928, c. 852, 45 Stat. 791, providing that "a stock dividend shall not be subject to tax." The Tax Court held (R. 64) that the stock dividends were nontaxable in the hands of the distributees and the taxpayer assigned no error with respect to this holding in the Circuit Court of Appeals (R. 72–74).

The books of Abercrombie & Fitch Company showed a deficit in surplus account of $399,771.87 on January 31, 1936. (R. 60.) However, the earnings of $844,100, which were capitalized on the company's books but which remained earnings for tax purposes, are sufficient to eliminate the deficit in surplus and also pay the cash distribution of $271,032.84. Moreover, the company had net earnings of $309,073.70, after taxes, for the taxable year ended January 31, 1937. (R. 16.)

[4] Certiorari was denied in the *Beretta* case by this Court on October 9, 1944. The petition for certiorari in that case did not question the lower court's holding that a nontaxable stock dividend does not diminish earnings and profits available for future distribution.

and *Van Norman Co.* v. *Welch*, 141 F. 2d 99 (C. C. A. 1st). See also *Century Electric Co.* v. *Commissioner* (C. C. A. 8th); decided October 2, 1944 (1944 P-H, par. 62,727). The decision is also in conflict with *Walker* v. *Hopkins*, 12 F. 2d 262 (C. C. A. 5th), certiorari denied, 271 U. S. 687, and *Nolde* v. *United States*, 64 C. Cls. 204, certiorari denied, 276 U. S. 634, which, even prior to the first appearance of Section 115 (h) in the Revenue Act of 1934, c. 277, 48 Stat. 680, held that non-taxable stock dividends did not have the effect of diminishing earnings and profits. The Tax Court has always followed the same rule: *Horrmann* v. *Commissioner*, 34 B. T. A. 1178, in which the earlier cases are collected; *F. J. Young Corp.* v. *Commissioner*, 35 B. T. A. 860, 865, affirmed on other grounds, 103 F. 2d 137 (C. C. A. 3d); *Chapman Price Steel Co.* v. *Commissioner*, decided September 7, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,411), pending on review (C. C. A. 7th). See also Treasury Regulations 94, Article 115-11 (Appendix, *infra*); 1 Paul & Mertens, Law of Federal Income Taxation, 356-357; and 1 Mertens, Law of Federal Income Taxation (1942), Section 9.47. *Contra* is *Byron Sash & Door Co.* v. *United States* (W. D. Ky.), decided April 10, 1944 (1944 P-H, par. 62,537), pending on Government's petition for review (C. C. A. 6th).

The court below failed to mention the foregoing authorities, although the Tax Court had

referred to many of them in its opinion. (R. 64–65.) Instead the court followed its own earlier decisions in *Commissioner* v. *Quackenbos*, 78 F. 2d 156; *Patty* v. *Helvering*, 98 F. 2d 717; and *De Nobili Cigar Co.* v. *Commissioner*, 143 F. 2d 436. Those cases announce the principle that where stock dividends were issued for a genuine business purpose, they converted earnings into capital, and that a subsequent distribution in redemption of the stock issued as stock dividends is a distribution out of capital and is not the equivalent of a taxable dividend within the meaning of Section 115 (g).[1] This view of the effect of a stock dividend, adopted in the *Quackenbos* and *Patty* cases, arose under the Revenue Act of 1928. That Act did not contain Section 115 (h), although it did contain in Section 112 (h) a provision that a distribution in a reorganization of stock or securities of a corporation which is a party to the reorganization shall not be considered a distribution of earnings or profits for the purpose of determining the taxability of subsequent distributions by the corporation. The extension of this rule in Section 115 (h) of the Revenue Act of 1936 to cover non-taxable stock dividends would seem to have definitely superseded the principle of the *Quackenbos* and *Patty* cases.

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[1] In the *De Nobili* case the court found that the stock dividends did not diminish earnings and profits because they were not issued for a genuine business purpose. There was

2. The decision of the court below that the cash distribution did not have the effect of a taxable dividend under Section 112 (c) (2), even though there were sufficient undistributed earnings to cover it, conflicts with *Love* v. *Commissioner*, 113 F. 2d 236 (C. C. A. 3d); *Campbell* v. *United States*, 114 F. 2d 177 (C. C. A. 3d); *Commissioner* v. *Owens*, 69 F. 2d 597 (C. C. A. 5th); *Commissioner* v. *Forhan R. Corp.*, 75 F. 2d 268 (C. C. A. 2d); and *Rose* v. *Little Inv. Co.*, 86 F. 2d 50 (C. C. A. 5th). See also *McCord* v. *Commissioner*, 31 B. T. A. 342; *Woodard* v. *Commissioner*, 30 B. T. A. 1216, petition for review dismissed April 24, 1935 (C. C. A. 3d); and *Woodward* v. *Commissioner*, 23 B. T. A. 1259. These cases establish the principle that if, prior to reorganization, a corporation has undistributed earnings and profits available for distribution as a taxable dividend, the distribution of an amount of cash not in excess of these earnings, pursuant to a plan of reorganization, has the effect of a taxable dividend within the meaning of Section 112 (c) (2), or equivalent provisions in the earlier Acts, and is to be taxed as a dividend. The court below did not so interpret Section 112 (c) (2), but on the contrary decided that Section 112 (c) (2) is to be construed as the court had formerly construed Section 115 (g) in *Commissioner*

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no reason in that case therefore to reexamine the principle of the *Patty* case in the light of Section 115 (h).

v. Quackenbos, 78 F. 2d 156, and *Patty* v. *Helvering*, 98 F. 2d 717; that is, to the effect that a distribution in redemption of stock which was not part of a plan of reorganization is essentially equivalent to the distribution of a taxable dividend only when it is not bona fide and is a mere cloak for the distribution of earnings.[8] But the instant case involves a distribution in a reorganization, and a transaction which is a mere device is outside that classification. *Gregory* v. *Helvering*, 293 U. S. 465. Accordingly, there is no occasion to limit Section 112 (c) (2) to distributions which are designed as a cloak. This section is applicable wherever the distribution has the effect of a dividend. Cf. *Helvering* v. *Credit Alliance Co.*, 316 U. S. 107.

The difference in phraseology between Sections 112 (c) (2) and 115 (g) is significant. Section 112 (c) (2) states only that if a distribution pursuant to a plan of reorganization has "the effect of the distribution of a taxable dividend" then the amount of gain recognized shall be "taxed" as a dividend to the extent that it represents "un-

[8] Other courts, however, have construed Section 115 (g) somewhat differently. Cf. *Hill* v. *Commissioner*, 66 F. 2d 45 (C. C. A. 4th); *Robinson* v. *Commissioner*, 69 F. 2d 972 (C. C. A. 5th); *Hyman* v. *Helvering*, 71 F. 2d 342 (App. D. C.), certiorari denied, 293 U. S. 570; *Randolph* v. *Commissioner*, 76 F. 2d 472 (C. C. A. 8th); *Brown* v. *Commissioner*, 79 F. 2d 73 (C. C. A. 3d).

distributed" earnings and profits. But Section 115 (g) is much more limited. It provides that if a corporation redeems stock "at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend," the amount so distributed shall be "treated" as a taxable dividend to the extent that it represents a distribution of "accumulated" earnings and profits. Thus Section 115 (g) prescribes that even though a liquidating distribution may be out of earnings, its equivalence to a taxable dividend depends on the time and manner in which made; whereas Section 112 (c) (2), as construed by the courts, applies to a distribution in a reorganization if there are earnings and profits to cover it, without any limitations as to the time and manner in which the distribution may have been made.

3. In holding that the cash disbursement was a distribution in partial liquidation, as defined in Section 115 (i), rather than a distribution in connection with a reorganization, the court below has dealt with an isolated step in the reorganization, contrary to the Tax Court's treatment. Since the Tax Court regarded the so-called liquidation as an incident of the reorganization, the court below was not at liberty to give separate effect to it. *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231.

Moreover, the decision below confuses reorganization exchanges with liquidating distributions and conflicts in result with *Love* v. *Commissioner*, 113 F. 2d 236 (C. C. A. 3d); and *Commissioner* v. *Owens*, 69 F. 2d 597 (C. C. A. 5th). See also the other cases cited under point 2 above. Those cases treat a distribution of earnings and profits in partial consideration for the surrender of old stock in a reorganization as controlled by Section 112 (c), and not as a distribution in partial liquidation. See also *Helvering* v. *Leary*, 93 F. 2d 826 (C. C. A. 4th); *Helvering* v. *Schoellkopf*, 100 F. 2d 415 (C. C. A. 2d); *Commissioner* v. *Kolb*, 100 F. 2d 920 (C. C. A. 9th); and *Commissioner* v. *Food Industries*, 101 F. 2d 748 (C. C. A. 3d), which did not involve Section 112 (c) (2), but in which it was held that a distribution in a reorganization of earnings accumulated after February 28, 1913, in partial cancellation of stock resulted in a taxable dividend rather than a liquidating distribution. See also *Woodard* v. *Commissioner*, 30 B. T. A. 1216, in which it is pointed out that even a liquidating distribution may have the effect of a taxable dividend under Section 112 (c) (2), if it is made from earnings.

Thus, the fact that one class of stock was retired as an incident of the reorganization is immaterial, even though the distribution, if detached from the reorganization, might otherwise qualify as a partial liquidating distribution, as defined

in Section 115 (i). Nearly every reorganization plan includes the retirement or cancellation of one or more classes of stock which are surrendered in exchange for new stock or securities, but in such case the cancellation of the old stock is merely one of the steps in the plan of reorganization. *Hammans* v. *Commissioner*, 121 F. 2d 4 (C. C. A. 2d), relied on by the court below (R. 81), is not contrary, for that case involved only a liquidation not in connection with a statutory reorganization. When the distribution, as here, is pursuant to a reorganization as defined in Section 112 (g), the method of taxing the distribution is determined by the provisions of Section 112 (c), which are complete in themselves. But if the distribution is one in partial or complete liquidation and is not an incident of a reorganization, Section 115 (c) fixes the extent and manner in which the gain on the distribution is to be taxed. This section is not to be read as a gloss upon Section 112 (c) (2) but, on the contrary, applies only to non-reorganization liquidations. The decision of the

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It is to be noted that if the exchange of stock for stock and cash in this case is properly treated as a distribution in partial liquidation, rather than a distribution in a reorganization, under the provisions of Section 115 (c) the gain of $139,740 on the exchange would be recognized to the extent of the cash received and, to the extent recognized, would be taxed in full as ordinary gain. The result would therefore be the same as when Section 112 (c) (2) is applied. Although the Circuit Court of Appeals held flatly that the distribution in this case was one in partial liquidation, it failed to

court below has confused the hitherto clear distinction between reorganizations and liquidations and the provisions of law applicable to each, and a clarifying decision by this Court is needed.

4. The treatment of the distribution as a liquidating dividend led to the further holding that the cash distribution in this case was properly chargeable to capital account. In this the court below misapplied this Court's decision in *Foster* v. *United States*, 303 U. S. 118. That decision was specifically limited in the opinion to "stock purchases of the type" there involved and did not purport to lay down a general rule that all distributions in partial liquidation are properly chargeable to capital account, as the court below interpreted it. See *Helvering* v. *Jarvis*, 123 F. 2d 742 (C. C. A. 4th). The general understanding of the term "capital account" is that it includes the profits accumulated prior to 1913, in addition to capital stock. See *Helvering* v. *Credit Alliance Co.*, *supra*, at p. 111. Unlike the *Foster* case, this case presents no issues with respect to whether the liquidating distribution is chargeable to pre-1913 earnings or post-1913 earnings, or as to the effect of the distribution on the taxability of subsequent distributions by the same corporation.

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recognize that under Section 115 (c) the gain on such a liquidation was taxable in full as ordinary gain and that the deficiency found by the Tax Court should be sustained even upon this theory.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

CHARLES FAHY,
Solicitor General.

NOVEMBER, 1944.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * * * *

(b) *Exchanges Solely in Kind.*—

* * * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * * *

(c) *Gain from Exchanges not Solely in Kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribu-

tion of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) [As amended by Sec. 213 (*g*) (1) of the Revenue Act of 1939, c. 247, 53 Stat. 863, 871] The term "reorganization" means * * * or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the ex-

tent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) [As amended by Sec. 205 of the Revenue Act of 1937, c. 815, 50 Stat. 813] *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117 (a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is

made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee be-

cause it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 115-11. *Effect on earnings or profits on certain tax-free exchanges and tax-free distributions.*—If, under the law applicable to the year in which any transfer or exchange of property after February 28, 1913, was made (including transfers in connection with a reorganization or a complete liquidation under section 112 (b) (6) and inter-company transfers of property during a period of affiliation), gain or loss was not recognized (or was recognized only to the extent of the property received other than that permitted by such law to be received without the recognition of gain), then proper adjustment and allocation of the earnings or profits of the transferor shall be made as between the transferor and transferee corporations.
>
> The general rule provided in section 115 (b) that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to:
>
> (1) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, to its shareholders of stock or securities in such corporation or in another corporation a party to the reorganization—
>
> (A) in any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112 (g) of the Revenue Act of 1932); or
>
> (B) in any taxable year (beginning before January 1, 1936, or on or after such date) in exchange for its stock or securities (see section 112 (b) (3))

if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(2) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

A distribution described in paragraphs (1) and (2) above does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange.

For the purposes of this article, the terms "reorganization" and "party to the reorganization" shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1932, and for any taxable year beginning after December 31, 1933, and before January 1, 1936, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934.

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 710

COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Tax Court (R. 38–42) is reported at 1 T. C. 478. The opinion of the Circuit Court of Appeals (R. 48–51) is reported at 144 F. 2d 272.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 29, 1944 (R. 51–52). The petition for a writ of certiorari was filed on November 29, 1944, and was granted on January

8, 1945 (R. 52). The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925. The question as to the Court's jurisdiction, raised by the respondent, is discussed, *infra,* pp. 9–22, as requested by the Court in the order granting certiorari (R. 52).

QUESTIONS PRESENTED

1. Whether the petition for a writ of certiorari was filed within three months after entry of the judgment of the Circuit Court of Appeals as required by Section 8 of the Act of February 13, 1925, c. 229, 43 Stat. 940.

2. Whether so much of the cash received by the taxpayer in an exchange of old stock for new stock and cash pursuant to a plan of reorganization of Abercrombie & Fitch Company as equals the gain recognized on the transaction under Section 112 (c) (1) of the Revenue Act of 1936 was paid out of earnings and had the effect of a taxable dividend, so that it is to be taxed as a dividend as provided in Section 112 (c) (2).

STATUTES AND AUTHORITIES INVOLVED

The applicable statutes and authorities are set out in Appendix A, *infra,* pp. 61–70.

STATEMENT

The following are the relevant facts as stipulated (R. 8–37) and as stated by the Tax Court (R. 38–39):

Edward T. Bedford died on May 21, 1931. The Title Guarantee & Trust Company is the executor of his estate. (R. 8, 38.)

Among Bedford's assets were 3,000 shares of 7% cumulative preferred stock, par value $100, of Abercrombie & Fitch Company, which had a fair market value on the date of his death of $210,000. In January, 1937, pursuant to a plan of recapitalization of Abercrombie & Fitch Company, the executor exchanged the 3,000 shares of 7% preferred stock for 3,500 shares of $6 cumulative preferred stock, par value $75, 1,500 shares of common stock, par value $1, and a cash distribution of $45,240 computed at the rate of $15.08 on each of the old preferred shares. The stock and cash so received had a fair market value of $349,740 and the gain on the exchange was $139,740. (R. 8–9, 38–39.)

On January 31, 1936, the books of Abercrombie & Fitch Company showed a deficit in surplus account of $399,771.87, after deduction of three stock dividends totaling $844,100, paid in 1920, 1928, and 1930.[1] For its fiscal year ended January 31, 1937, the company had net earnings of $309,073.70 after taxes. (R. 9, 39.)

The parties agreed before the Tax Court that the recapitalization of Abercrombie & Fitch Company constituted a reorganization as defined in

[1] These stock dividends were all non-taxable to the distributees, as will be shown, *infra*, p. 24, note 13.

Section 112 (g) of the Revenue Act of 1936;[2] and that the gain of $139,740 on the exchange of old stock for new stock and cash was recognized for tax purposes only to the extent of the cash received, or $45,240, under the provisions of Section 112 (b) (3) and (c) (1). The taxpayer contended, however, that the cash distribution represented a capital gain, only 40% of which was taxable under the provisions of Section 117 (a). (R. 38, 39.) The Commissioner determined that the cash distribution had the effect of a taxable dividend and was to be taxed as a dividend, as provided in Section 112 (c) (2) (R. 5–6, 38).

The Tax Court held (R. 40–42) that the distribution of $45,240 in cash was made out of the accumulated earnings and profits of Abercrombie & Fitch Company and had the effect of a taxable dividend, even though it was not in form a dividend. It therefore sustained the Commissioner's determination that the cash distribution was taxable as a dividend under the provisions of Section 112 (c) (2).

The Circuit Court of Appeals reversed (R. 49–51), holding, first, that the Abercrombie & Fitch Company had no accumulated earnings and profits out of which the cash distribution of $45,240 might have been taken because the

[2] Subsequent references are to the Revenue Act of 1936 unless otherwise indicated. All the sections of the Revenue Act of 1936 referred to in the brief will be found in Appendix A, *infra*.

stock dividends which had been paid in prior years had converted the earnings into capital; second, that the distribution was not governed by Section 112 (c) (2), but was instead a liquidating dividend governed by Section 115; and, third, that the distribution was properly chargeable to capital account, even though the company may have had accumulated earnings.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that earlier non-taxable stock dividends had converted earnings into capital with the consequence that the Abercrombie & Fitch Company had no undistributed earnings in the taxable year.

2. In holding that the cash distribution did not have the effect of a taxable dividend because Section 115 (g) should be read as a gloss upon Section 112 (c) (2).

3. In holding that the distribution was governed by Section 115 instead of Section 112 (c) (2) and hence was a liquidating dividend.

4. In holding that, as a part of a liquidating dividend, the cash distribution is properly chargeable to capital account.

SUMMARY OF ARGUMENT

I

The petition for a writ of certiorari was filed within three months after entry, on August 29,

1944, of the judgment order of the lower court and hence was filed within the time allowed by law. Although it was labeled "order for mandate", the order of August 29, 1944, formally rendered judgment as of its date, and further provided that a mandate issue in accordance with "this decree". The opinion of the court did not constitute its judgment; it merely stated the conclusion reached by the court with respect to the case and gave reasons therefor. Even if the conclusion stated in the opinion could be considered as the judgment in the absence of a further order, the subsequent formal order is the final judgment and is given effect as such for purposes of computing the time in which to petition for certiorari. It is the practice in the Second Circuit to enter a formal order for mandate as was done in this case, and this order is intended as the judgment. The order in this case was prepared and signed by the Clerk pursuant to authority delegated to him by the court, and in legal effect it was the act of the court.

Applications for a writ of certiorari in the past have been made and granted on the understanding that the order for mandate constituted the court's judgment. This long-accepted practice does not result in giving a longer period in which to petition for certiorari in cases from the Second Circuit than that allowed with respect to cases from other circuits. The period is three months

from entry of judgment in the Second Circuit, as well as in other circuits.

II

The gain realized by the taxpayer in 1937 upon an exchange of old stock for new stock and cash, pursuant to a plan of recapitalization, is recognized under the statute only to the extent of the cash distribution. If the cash distribution was not in excess of the accumulated earnings and profits, it had the effect of a taxable dividend and is to be taxed as a dividend under the provisions of Section 112 (c) (2) of the Revenue Act of 1936.

The recapitalized corporation had accumulated earnings and profits in excess of the cash distribution. Although the books of the corporation showed a deficit in surplus account at the time of the distribution, the deficit resulted in part from the reduction of surplus by three stock dividends which were non-taxable to the distributees. Section 115 (h) prescribes that a distribution at any time of a non-taxable stock dividend shall not be considered a distribution of earnings and profits. This is the rule followed by the great weight of authority, both prior and subsequent to the enactment of Section 115 (h). The amounts of earnings charged to surplus upon issuance of the stock dividends are therefore to be treated as undistributed earnings and profits available for distribution in 1937.

The test of whether a distribution has the effect of a distribution of a taxable dividend under Section 112 (c) (2) is the existence of earnings and profits, and not the bona fides of the transaction. Since Section 112 (c) (2) applies only in the case of distributions pursuant to a statutory reorganization, its scope can not be limited to tax avoidance devices; such devices do not qualify as statutory reorganizations. Nor does the circumstance that the capitalization of the corporation was reduced in the transaction preclude treatment of the distribution as a taxable dividend. The Tax Court's finding that the distribution had the effect of a taxable dividend is fully supported and should have been accepted by the Circuit Court of Appeals.

The distribution of new stock and cash in exchange for the old stock is not within the statutory definition of a distribution in partial liquidation because all, and not merely a part, of the old stock was retired. But even if it be assumed that the distribution, standing alone, falls literally within the definition of a partial liquidation, the distribution was merely a step in a reorganization. Where a reorganization is involved, the provisions of the statute relating to reorganizations control the method of taxing the distribution made pursuant thereto.

However, if the view of the lower court that the distribution was one in partial liquidation be accepted, the gain on the exchange is, under the

provisions of Section 115 (c), taxable in full. The tax is thus no less than it would be were the gain taxed as a dividend under Section 112 (c) (2). The question of whether the distribution was properly chargeable to capital account is irrelevant to this question. The taxpayer as a stockholder is to be taxed on its entire gain, after recovery of its capital base, on the liquidating exchange, regardless of whether the distribution be charged by the corporation to earnings and profits or to capital account.

ARGUMENT

I

THE PETITION FOR A WRIT OF CERTIORARI WAS FILED WITHIN THE TIME ALLOWED BY LAW

On August 8, 1944, the court below filed its opinion in which it stated its reasons for reversing the decision of the Tax Court and concluded with the sentence, "The order of the Tax Court is reversed" (R. 51). On the same day, the Clerk made the following docket entry: "Order reversed, A. N. Hand, C. J" (See Br. in Opp. 17).

On August 29, 1944, the following order, labeled "Order for Mandate", was filed (R. 51–52):

> At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 29th day of August, one thousand nine

hundred and forty-four, Present: Hon. Learned Hand, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges. Estate of Edward T. Bedford, Title Guarantee & Trust Company, Petitioner v. Commissioner of Internal Revenue, Respondent. Appeal from The Tax Court of the United States.

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

ALEXANDER M. BELL,
Clerk.

By A. DANIEL FUSARO,
Deputy Clerk.

United States Circuit Court of Appeals, Second Circuit. Estate of Edward T. Bedford etc., v. Commissioner of Internal Revenue. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Aug. 29, 1944. Alexander M. Bell, Clerk.

On the same day the Clerk made two separate entries as follows (Br. in Opp. 17):

Filed order for mandate.

Issued mandate.

On November 29, 1944, the Solicitor General filed the petition for a writ of certiorari. In its brief in opposition, the taxpayer argued that this Court has no jurisdiction because the petition was not filed within three months after the entry of the judgment or decree of the lower court, as prescribed by Section 8 (a) of the Act of February 13, 1925 (Appendix A, *infra* p. 61). In the order granting certiorari, this Court requested that the parties discuss in their briefs and on oral argument the question whether the application for certiorari was within the time provided by law (R. 52).

Resolution of the question as to whether the petition for certiorari was timely under Section 8 (a) of the Act of February 13, 1925, turns on a determination of what constitutes the judgment or decree of the lower court. The taxpayer appears to contend that the concluding sentence of the opinion constitutes the court's judgment. The Government submits that the "Order for Mandate" is the court's judgment. Since the petition for a writ of certiorari was filed within three months after the date on which the order for mandate was filed and entered on the docket, it was applied for within the time prescribed by the statute.[3]

[3] The time in which to petition for certiorari under the statute runs from "entry" of judgment. Here the order for mandate was filed, and the Clerk's docket entry of the order was made, both on August 29, 1944. It is unnecessary in this case, therefore, to decide which of these two events con-

The order for mandate (R. 51–52) shows on its face that it is the judgment or decree of the court and that it was so intended.[4] The order recites that "it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed." It "further ordered" that a mandate issue in accordance with "this decree." (R. 51.) Thus the order formally rendered judgment as of its date. The terminology is that in which final judgments

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stitutes the entry of the judgment. It has been held, however, that the "entry" consists of the act of the Clerk in re-recording the court's judgment in an order or record book. See *Ex parte Morgan*, 114 U. S. 174, 175; *Polleys* v. *Black River Co.*, 113 U. S. 81, 84; *United States* v. *Rayburn*, 91 F. 2d 162, 164 (C. C. A. 8th); *The Washington*, 16 F. 2d 206 (C. C. A. 2d); cf. *In re Hurley Mercantile Co.*, 56 F. 2d 1023, 1025 (C. C. A. 5th), certiorari denied *sub nom. Atascosa County State Bank* v. *Coppard*, 286 U. S. 555, holding that a judgment is entered or rendered when filed with the Clerk.

[4] The label attached to the order is not determinative as to whether it constitutes the court's judgment. This Court has made that plain in *United States* v. *Hark*, 320 U. S. 531, 534, where it said:

"The judgment of a court is the judicial determination or sentence of the court upon a matter within its jurisdiction. No form of words and no peculiar formal act is necessary to evince its rendition or to mature the right of appeal. And the modes of evidencing the character of the judgment and of attesting the fact and time of its rendition vary from state to state according to local statute or custom, from a simple docket entry or the statement of a conclusion in an opinion, to a formal adjudication, signed by the judge or the clerk, in a journal or order book, or filed as part of the record in the case. The practice in federal courts doubtless varies because of the natural tendency to follow local state practice."

and decrees are customarily couched and the order referred to itself as "this decree." The fact that the order now hereby adjudges and decrees a reversal of the order of the Tax Court indicates that judgment had not previously been rendered. The direction for issuance of a mandate in accordance with "this decree" only confirms the conclusion that the order, and not some previous action of the court, was the effective judgment.[5]

In contrast, the opinion does not formally render judgment nor is the terminology like that used in final judgments. The last sentence of the opinion that the order of the Tax Court is reversed is one of the customary ways of concluding an opinion and would seem to be no more than a statement as to the conclusion reached with respect to the case. "The court's decision of a case is its judgment thereon. Its opinion is a statement of the reasons on which the judgment rests." *Rogers* v. *Hill*, 289 U. S. 582, 587. The court below obviously did not regard the opinion as its judgment; it later filed a formal order ren-

[5] The mandate itself was a separate order; as the docket entries of the Clerk for August 29, 1944, plainly show. It was an order addressed to the Tax Court, issued pursuant to the direction in the order for mandate. The taxpayer's argument (Br. in Opp. 7–8) that if the order for mandate is the judgment, there could be no stay of the mandate upon application for certiorari appears to confuse the order for mandate with the mandate itself. Since the mandate is a separate order, it could be stayed or recalled without disturbing the order for mandate containing the court's judgment.

dering judgment, which would have been only an empty form if judgment had already been entered.

Even if it be assumed *arguendo* that the concluding sentence of the opinion might without a further order have been treated as the judgment with respect to which a petition for certiorari might have been filed, the entry of a subsequent formal judgment is the last action of the court and therefore the operative and final judgment. This view is supported by *Rubber Co.* v. *Goodyear,* 6 Wall. 153. There an order was entered on the minute book on November 28, 1866, which was followed by a final decree on December 5, 1866, entered "as of Nov. 28, 1866." The Court said (pp. 155–156):

> We do not question that the first entry had all the essential elements of a final decree, and if it had been followed by no other action of the court, might very properly have been treated as such. But we must be governed by the obvious intent of the Circuit Court, apparent on the face of the proceedings. We must hold, therefore, the decree of the 5th of December to be the final decree.

See also *Silsby* v. *Foote,* 20 How. 290, 295, indicating that an appeal might be taken alternatively from the pronouncement and entry of a decision or from the subsequent settling and signing of the decree by the judge. Cf. *United States* v. *Rayburn,* 91 F. 2d 162 (C. C. A. 8th); *Wright* v.

Gibson, 128 F. 2d 865 (C. C. A. 9th); *Monarch Brewing Co.* v. *George J. Meyer Mfg Co.*, 130 F. 2d 582 (C. C. A. 9th). In this case, it will be noted that the petition for certiorari was filed with respect to the last "judgment", entered August 29, 1944. Cf, *United States* v. *Midstate Co.*, 306 U. S. 161, 163, footnote 2.

The conclusion that the order for mandate alone constitutes the court's judgment is confirmed by information as to the practice in the Second Circuit contained in a letter written by the Clerk of the Circuit Court of Appeals for the Second Circuit in reply to a letter of the Solicitor General, both of which are printed in Appendix B, *infra*, pp. 73–78.[6] From this it appears that the opinion was not considered as the court's judgment and that the docket entry made on August 8, 1944, to record the opinion, was not the entry of judgment but merely showed briefly how the court decided the case and who wrote the opinion. The Clerk's letter indicates further that it is the practice to enter judgments labeled orders for mandate, under paragraph 1 of Rule 30 of the lower court's rules (Appendix A, *infra*, pp. 61–62), at the expiration of fifteen days from the filing of the opinion, and that this time interval between the opinion and the judgment is observed pursuant to the express direction of the court. The provision of the rule

[6] Appendix B contains the entire correspondence between counsel in this case and the Clerk of the Circuit Court of Appeals for the Second Circuit.

that upon the filing of any decision the Clerk shall enter the proper order "forthwith, or at any later time, if the court thinks justice requires it" has thus been made definite by the court's instruction as to the time when the order is to be entered.[7] There was no departure from the usual practice (except that the interval between the dates of the opinion and judgment was 21 days) in this case and, in view of the information given by the Clerk, there can be no question that the court's judgment was entered on August 29, 1944.[8]

This Court has decided in comparable situations that a formal order, entered some days after the court's opinion was filed, constituted the final and appealable judgment. *United States* v. *Hark*, 320

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[7] In any event the Clerk's docket entry of August 8 does not constitute compliance with the rule that the proper "order" be entered forthwith, because the docket entry is in no sense an "order", proper or otherwise.

[8] The practice with respect to entry of judgments in the Second Circuit differs from that of the other circuit courts of appeals. In each of the other circuits a separate judgment order is prepared which is usually entered on the date on which the opinion is filed. For the information of the Court, there is attached as Appendix C, *infra*, pp. 85–88, a summary of the practice followed in the other circuits. This information was obtained from the clerk of each court by letter in response to a letter of the Solicitor General. The clerks' letters will be filed with the Clerk of this Court, so that they will be accessible if the Court should wish to examine them. The Solicitor General's letter to the Clerk of the United States Court of Appeals for the District of Columbia is also printed in Appendix C, *infra*, pp. 84–85, as a sample of the letters, all of which were worded identically, sent to the clerk of each circuit court of appeals with the exception of the Second Circuit.

U. S. 531, involved the question whether an appeal had been taken from the District Court under the Criminal Appeals Act within thirty days after the decision or judgment was rendered. The District Judge filed an opinion on March 5, 1943, concluding with the sentence "The motion to quash is granted." Subsequently, on March 31, at the request of the United States Attorney the District Judge signed a formal order quashing the indictment, although it was not the prevailing practice of that court to enter formal orders. This Court stated that where a formal judgment is signed by the judge, it is *prima facie* the decision or judgment, rather than a statement in an opinion or a docket entry. The Court stated further that it was unwilling to assume that the District Judge deemed the formal judgment an empty form and held that the formal order was the court's judgment. See also *United States* v. *Midstate Co.*, 306 U. S. 161, 163, footnote 2, where the same holding was made upon similar facts except that it was shown that the practice of the District Court was to enter formal judgments after the filing of an opinion.[9] The instant case

[9] Other cases in which a formal judgment, rather than an opinion or a statement in an opinion, has been treated as the court's judgment for purposes of computing the time in which an appeal may be taken are: *United States* v. *Resnick*, 299 U. S. 207 (In this case the opinion of the District Court concluded "* * * the Demurrer is therefore, sustained"; subsequently a formal order was entered sustaining the demurrer; the petition for appeal was not timely if the opinion

more closely resembles the *Midstate Co.* case than the *Hark* case, for the practice in the Second Circuit is to enter an "order for mandate" in every case; this order is intended to be the court's judgment. See letter from Clerk dated January 23, 1945 (Appendix B, *infra*, pp. 74–78).

The taxpayer argues that the *Hark* case is distinguishable on the ground that the formal order in that case was the act of the judge, whereas in the instant case the order for mandate was not the act of the court. But we think it plain that the order for mandate was the judgment of the court. The order on its face purports to be the act of the three judges designated therein, in whose name judgment is given. It is true that the order for mandate was signed by the Clerk rather than by the judges, but this does not justify the conclusion that the order was a mere ministerial act of the Clerk, as taxpayer argues. On the contrary, the order was entered pursuant to the authority given the Clerk in Rule 39, paragraph 1 (Appendix A, *infra*, pp. 61–62), as amplified by the instruction of the court as to the time for

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was the court's judgment; this Court postponed consideration of the question of jurisdiction, raised by motion to dismiss, to the hearing of the case on the merits; the court entertained the appeal and did not discuss the question of its timeliness in its opinion.); *Puget Sound Co.* v. *King County*, 264 U. S. 22; *G. Amsinck & Co.* v. *Springfield Grocer Co.*, 7 F. 2d 855 (C. C. A. 8th); *The Santa Rita*, 281 Fed. 760, 761 (C. C. A. 5th), certiorari denied, 260 U. S. 735. See also 1 Freeman, *Judgments* (fifth ed.), Sec. 3.

entry of the order. The order was therefore entered under powers delegated by the court to the Clerk, and in legal effect it was the act of the court.[10] Cf. *Ex parte Morgan*, 114 U. S. 174, 175.

Moreover, it is the general understanding, as the taxpayer concedes (Br. in Opp. 8), that the order for mandate is the judgment or decree of the Circuit Court of Appeals for the Second Circuit and that the time within which to apply for certiorari runs from the date of entry of that order by the Court. Robertson and Kirkham, *Jurisdiction of the Supreme Court of the United States* (1936), Section 384. Indeed, so far as is known it has never before been argued in this Court that a petition for certiorari, filed within three months of the entry of the order for mandate in the Circuit Court of Appeals for the Second Circuit, was not timely. This Court has taken and decided numerous cases where the petition was filed more than three months after the date of the opinion but within three months after entry of the order for mandate. Among such cases selected from recent terms are *Helvering* v. *Lerner Stores Co.*, 314 U. S. 463; *United States* v. *New York*, 315

[10] It may be noted that in the Circuit Courts of Appeals for the First, Eighth and Tenth Circuits, the Clerk prepares and signs the judgment orders pursuant to the authority delegated to him by the court (although in the First Circuit the judgment is initialed by the Senior Circuit Judge). Whether the judgment order is signed by the court or the Clerk in the Fifth, Seventh, and Ninth Circuits does not appear. See Appendix C, *infra*, pp. 85–88.

U. S. 510; and *Strassburger* v. *Commissioner*, 318 U. S. 604, wherein this Court reversed the judgment of the Circuit Court of Appeals for the Second Circuit without reference to the fact that the petitions for certiorari were filed too late if the entry of the court's opinion constituted entry of its judgment.[11] Acceptance of the taxpayer's contention here would mean that this Court had no jurisdiction in the foregoing cases and in the many other cases which could be cited.

Treatment of the order for mandate as the judgment does not result in giving a longer period in which to petition for certiorari in cases decided by the Second Circuit over the period allowed in cases decided by other circuits, as

[11] In other cases involving the same situation with respect to the filing of the petition for certiorari, the Court has affirmed the judgment below. See, e. g., *Equitable Society* v. *Commissioner*, 321 U. S. 560; *Helvering* v. *Griffiths*, 318 U. S. 371; *Smith* v. *Shaughnessy*, 318 U. S. 176.

During this term the Court has granted certiorari and has heard argument in *State of New York* v. *United States*, No. 83, although the petition for certiorari was filed more than three months after the date of the opinion but within three months of the order for mandate. The situation was the same in *Angelus Milling Co.* v. *Nunan*, No. 610, and *Goldstone* v. *United States*, No. 699, in which certiorari was granted this term. During this term also, the Court has denied certiorari in several cases from the Second Circuit without reference to the fact that the petitions were filed too late if the entry of the court's opinion is taken as the judgment. See *Commissioner* v. *Estate of Shamberg*, No. 707, and *Commissioner* v. *Estate of White*, No. 708, certiorari denied, January 2, 1945; *International Standard Electric Co.* v. *Commissioner*, Nos. 739–740, certiorari denied, January 29, 1945.

taxpayer suggests. On the contrary, the time in which to apply for certiorari with respect to judgments of the Second Circuit is the same as for other circuits, namely, three months from entry of judgment. It is true that the period in which to apply for certiorari in Second Circuit cases is more than three months after entry of the opinion, whereas in other circuits the period generally is only three months from the date of the opinion, due to the fact that entry of judgment coincides with the date of the opinion. This fact, is however, irrelevant, because the statute prescribes the date on which "judgment" is entered as the date from which the period in which to petition for certiorari is to be computed, and the statute does not require that the judgment be entered at any particular time.

In *Dept. of Banking* v. *Pink*, 317 U. S. 264, cited by taxpayer, this Court's view was simply that the time in which to apply for certiorari begins to run from the time of entry of judgment by the Court of Appeals of New York rather than from the time when a lower court enters judgment on the remittitur of the Court of Appeals. This was in conformity with the statute governing appeals from state courts and with the rule applied to cases from other state courts.[12]

[12] Section 237 of the Judicial Code (28 U. S. C. 344) provides for an appeal from "A final judgment or decree in any suit *in the highest court of a State* * * *." (Italics supplied.)

The case is not apposite here, however, because this case does not involve the question as to whether the judgment of the Circuit Court of Appeals or the decision of the Tax Court on mandate is the appealable judgment. Furthermore, there is nothing in the opinion in *Dept. of Banking* v. *Pink, supra,* to support the view that the lower court's opinion should be treated as its judgment.

II

THE CASH RECEIVED BY TAXPAYER IN THE RECAPITALIZATION OF ABERCROMBIE & FITCH COMPANY IS TAXABLE AS A DIVIDEND

The taxpayer, in January, 1937, exchanged old preferred stock of Abercrombie & Fitch Company owned by it for new preferred stock and new common stock in the same company and $45,240 in cash. The old stock had a cost basis to the estate of $210,000. The new stock and cash received had a fair market value on the date of the exchange of $349,740. (R. 38.) Thus the estate realized an actual gain on the exchange of $139,740. The parties are agreed, however, that the exchange of stock for stock was made pursuant to a plan for recapitalization and hence was a statutory reorganization (see Section 112 (g) of the Revenue Act of 1936, as amended, Appendix A, *infra,* pp. 64–65), and further, that under Section 112 (b) (3) and (c) (Appendix A, *infra,* pp. 63–64) the gain on the exchange is not recog-

nized for tax purposes except in an amount not in excess of the cash involved, or $45,240.

The controversy relates only to the manner in which this gain shall be taxed under Section 112 (c). The taxpayer contends that only the provisions of Section 112 (c) (1) apply and that the amount of $45,240 is taxable thereunder as a capital gain. The Government contends, however, that, as the Tax Court held, the provisions of Section 112 (c) (2) apply to the facts here, that the corporation had earnings and profits available to cover the cash distribution, and that Section 112 (c) (2) requires that the total recognized gain be taxed as a dividend. Further, the Government contends that the court below incorrectly held that the distribution was taxable under Section 115 (c) and (i) (Appendix A, *infra*, pp. 67–68) as a distribution in partial liquidation, and improperly failed to hold that if it were, 100% of the gain would be taxable.

A. *Abercrombie & Fitch Company had earnings and profits available for distribution in January 1937, in excess of the cash distributed at that time.*—For the period from January 1, 1913, to January 31, 1936, Abercrombie & Fitch Company had net earnings, which were credited to surplus account, in the amount of $2,443,123.50, and during the same period it paid cash dividends totaling $1,208,325.05. On January 31, 1936, as a result of other debits and credits, its books showed a deficit in surplus account of $399,771.87.

Among the debits to surplus which contributed to the creation of this deficit were three stock dividends totaling $844,100 paid in 1920, 1928, and 1930. (R. 37.) None of these dividends were taxable in the hands of the distributee.[13]

Section 115 (h) (Appendix A, *infra*, p. 67) prescribes in the clearest possible manner that the distribution by a corporation of a stock dividend which is not taxed as income to the recipient does not serve to diminish corporate earnings or profits. The Section provides:

> (h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

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[13] The stock dividend of $161,700 paid in common stock on the common stock on April 30, 1920, was not taxable under the rule of *Eisner* v. *Macomber*, 252 U. S. 189, and *Helvering* v. *Griffiths*, 318 U. S. 371. The stock dividends of $323,400 and $359,000 issued in 1928 and 1930, respectively, were paid in preferred stock on the common stock and were nontaxable under Section 115 (f) of the Revenue Act of 1928, c. 852, 45 Stat. 791, providing that "A stock dividend shall not be subject to tax."

The Tax Court held that the stock dividends were nontaxable in the hands of the distributees and this holding is not in issue, since the taxpayer assigned no error with respect to it in the Circuit Court of Appeals (R. 45–46).

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

The language of Section 115 (h) is plain. It refers *inter alia* to a distribution by a corporation of its own stock and securities, whether before or after January 1, 1936. It provides that a stock dividend shall not be considered as a distribution of earnings or profits; that is, that tax-wise it does not affect earnings or profits but leaves them intact for future distribution; if the distribution is non-taxable under the Sixteenth Amendment or under express provisions of Section 115 (f) of the Revenue Act of 1934 or corresponding provisions of some of the earlier statutes which exempted from tax all stock dividends. See Article 115–11, Treasury Regulations 94, promulgated under the Revenue Act of 1936 (Appendix A, *infra* pp. 68–70); Article 115–11, Treasury Regulations 101, promulgated under the Revenue Act of 1938; Section 19.115–11, Treasury Regulations 103, and Section 29.115–11, Treasury Regulations 111,

both promulgated under the Internal Revenue Code.[14]

Many decisions of the lower courts support this construction. *Chapman Price Steel Co.* v. *Commissioner* (C. C. A. 7th), decided December 15, 1944; *Century Electric Co.* v. *Commissioner,* 144 F. 2d 983 (C. C. A. 8th); *Beretta* v. *Commissioner,* 141 F. 2d 452 (C. C. A. 5th), certiorari denied, October 9, 1944; *Van Norman Co.* v. *Welch,* 141 F. 2d 99 (C. C. A. 1st); *American Gypsum Co.* v. *Commissioner,* decided March 29, 1944 (1944 P-H Tax Court Memorandum Decisions Service, par. 44,094). To the same effect see 1 Mertens, *Law of Federal Income Taxation* (1942), Sec. 9.47; 1 Paul & Mertens, *Law of Federal Income Taxation,* (1934), 356–357; Rudick, *"Dividends" and "Earnings or Profits" Under the Income Tax Law: Corporate Non-Liquidating Distributions,* 89 U. of Pa. L. Rev. (1941) 865, 878, 897–898. Cf. *Byron Sash & Door Co.* v. *United States* (W. D. Ky.), decided April 10, 1944 (1944 P-H, par. 62,537), pending on review (C. C. A. 6th), in which no mention was made of Section 115 (h).

Moreover, while the language of Section 115 (h) relating to the effect on earnings of distributions of non-taxable stock dividends first appeared

[14] Section 115(h) was reenacted in the Revenue Act of 1938 and in the Internal Revenue Code in slightly amended form, but the amendments made have no relevance in this case.

in the Revenue Act of 1936,[15] its provisions in no respect represented a departure from existing principles. The Section merely states in explicit statutory language a conclusion already embodied in judicial decisions and administrative regulations. For example, in *Walker* v. *Hopkins*, 12 F. 2d 262 (C. C. A. 5th), certiorari denied, 271 U. S. 687, the court rejected the contention that a prior distribution of a stock dividend had distributed accumulated earnings so as to leave the corporation without sufficient earnings to cover a subsequent cash distribution. The court said (p. 263):

> * * * it is clear that the stock dividend of January 1, 1917, was not a distribution of profits or accretions at all, and left the accumulations of the corporation untouched and available for future disposal.

[15] Section 115 (h) of the Revenue Act of 1934, c. 277, 48 Stat. 680, provided only that:

"The distribution before January 1, 1934, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, if no gain to the distributee from the receipt of such stock or securities was recognized by law, shall not be considered a distribution of earnings or profits within the meaning of this section for the purpose of determining the taxability of subsequent distributions by the corporation. As used in this subsection, the terms "reorganization" and "party to the reorganization" shall have the meanings assigned to such terms in section 112 of the Revenue Act of 1932."

A similar provision appears as Section 203 (g) of the Revenue Acts of 1924 and 1926, and as Section 112 (h) of the Revenue Acts of 1928 and 1932.

To the same effect are *Nolde* v. *United States*, 64 C. Cls. 204, certiorari denied, 276 U. S. 634; *McCord* v. *Commissioner*, 31 B. T. A. 342; *Horrmann* v. *Commissioner*, 34 B. T. A. 1178; and *F. J. Young Corp.* v. *Commissioner*, 35 B. T. A. 860, 865, affirmed on other grounds, 103 F. 2d 137 (C. C. A. 3d); Article 115–10, Treasury Regulations 86, promulgated under the Revenue Act of 1934; cf. *Eisner* v. *Macomber*, 252 U. S. 189. *Contra* is *Patty* v. *Helvering*, 98 F. 2d 717 (C. C. A. 2d), which will be discussed *infra*.

Not only does the legislative history of Section 115 (h) indicate that its adoption was not intended as a change in existing law but merely desirable as a matter of clarity, but it also shows that Section 115 (h) means exactly what the language indicates, namely, that a stock dividend which is not taxable to the shareholder as income cannot be considered as diminishing accumulated earnings and profits for any purpose.[16]

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[16] S. Rep. No. 2156, 74th Cong., 2d Sess., p. 19 (1939–1 Cum. Bull. (Part 2), 678, 690) states with respect to Section 115 (h) as follows:

"SECTION 115 (H). EFFECT OF DISTRIBUTIONS ON EARNINGS AND PROFITS

"The rule, under existing law, with respect to the effect on corporate earnings or profits of a distribution which, under the applicable tax law, is a nontaxable stock dividend or a distribution of stock or securities in connection with a reorganization or other exchange, on which gain is not recognized in full, is that such earnings or profits are not dimin-

The three stock dividends paid by Abercrombie & Fitch Company are all of the type described in Section 115 (h) (2),[17] and under that Section they did not, for purposes of taxation, reduce its earnings and profits available for future distribution. Hence the amount of $844,100, although debited to surplus account on the company's books, remained available as earnings. After eliminating this amount from the debits to surplus account as required by Section 115 (h), Abercrombie & Fitch Company had at the very least $444,328.13 ($844,100 minus deficit of $399,771.87) of accumulated earnings which remained undistributed on January 31, 1936, even if all other charges to surplus for the period of 1913–1935 be treated as proper charges against earnings. Moreover, the

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ished by such distribution. In such cases, earnings or profits remain intact and hence available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange. This rule is stated only in part in section 115 (h) of the Revenue Act of 1934, and corresponding provisions of prior acts, but is the rule which is applied by the Treasury and supported by the courts in *Commissioner* v. *Sansome*, 60 Fed. (2) 931; *U. S.* v. *Kauffman*, 62 Fed. (2) 1045; *Murcheson* v. *Comm.*, 76 Fed. (2) 641. While making no change in the rule as applied under existing law, the recommended amendment is desirable in the interest of greater clarity."

[17] As shown above, p. 24, note 13, the 1920 stock dividend did not constitute income within the meaning of the Sixteenth Amendment to the Constitution, and the 1928 and 1930 stock dividends were exempt from taxation under Section 115 (f) of the Revenue Act of 1928.

company had net earnings of $309,073.70; after taxes for the fiscal year ended January 31, 1937, most of which were doubtless earned prior to the cash distribution in January, 1937, and were available for distribution at that time. Consequently there were undistributed earnings and profits accumulated after February 28, 1913, in excess of the total amount of $271,032.84 distributed to stockholders in the recapitalization.

The Circuit Court of Appeals ignored Section 115 (h) and the other authorities cited above and followed its own prior decisions in *Patty* v. *Helvering*, 98 F. 2d 717; *Commissioner* v. *Quackenbos*, 78 F. 2d 156; and *DeNobili Cigar Co.* v. *Commissioner*, 143 F. 2d 436. All three cases involved the question whether a redemption of stock issued as a stock dividend was made at such time and in such manner as to be essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g) of the Revenue Act of 1936 (Appendix A, *infra*, pp. 66–67) or the corresponding provisions of other statutes. The court held that where stock dividends were issued for a genuine business purpose, they converted earnings into capital and that a subsequent distribution in redemption of the stock issued as a stock dividend is a distribution out of capital, rather than a distribution of earnings, and is not the equivalent of a taxable dividend within the meaning of Section 115 (g). But the *Patty* and *Quackenbos*

cases arose under the Revenue Act of 1928, which did not contain any provision similar to Section 115 (h) of the Revenue Act of 1936.[18] Insofar as the decisions hold that a non-taxable stock dividend converts earnings into capital, they are in conflict with the great weight of authority on that question even prior to the enactment of Section 115 (h).[19] See *supra*, pp. 26–28. But regardless of whether or not the *Patty* and *Quackenbos* cases were correctly decided under the Revenue Act of 1928, the decisions certainly can not prevail against the statutory mandate of Section 115 (h) that a non-taxable stock dividend, regardless of when made, does not diminish earnings and profits for tax purposes. The statute, so long as it was within the power of Congress,[20] must control over decisions inconsistent therewith. See discussion in 1 Mertens, *Law of Federal Income Taxation*

[18] The *DeNobili* case did involve the Revenue Acts of 1936 and 1938. There it was held, however, that the prior stock dividends were not issued for a genuine business purpose and hence that they did not convert earnings into capital. There was, therefore, no occasion in that case to decide whether the principle of the *Patty* case should be overruled because it is contrary to Section 115 (h).

[19] The statement in the *Patty* case (pp. 718–719) that the cases of *Walker* v. *Hopkins*, 12 F. 2d 262 (C. C. A. 5th), certiorari denied, 271 U. S. 687, and *Nolde* v. *United States*, 64 C. Cls. 204, certiorari denied, 276 U. S. 634, are distinguishable because in them there was a balance of undistributed earnings after the stock dividends had been charged against them is not borne out by the facts in those cases.

[20] No claim is made that Section 115 (h) is unconstitutional.

(1942), Section 9.47, p. 490, which indicates that any question as to the correctness of the *Patty* case on this issue is now academic in view of the statute. The court below did not offer any reasons as to why Section 115 (h) does not apply here. Indeed the Section is not mentioned in the opinion, although the Tax Court had relied upon it. We submit that the Circuit Court of Appeals erred in failing to apply the Section and in failing to hold that there were earnings and profits available for distribution in January, 1937, in excess of the cash distributed at that time. It appears, moreover, that the taxpayer concedes that earnings and profits were available. (Br. in Opp. 10.)

B. *Under Section 112 (c) (2), a cash distribution not in excess of available earnings and profits has the effect of a distribution of a taxable dividend.*—As previously stated, the transaction here involved was a recapitalization and hence a reorganization. If only stock and securities had been received, the exchange would have been tax-free under Section 112 (b) (3). But cash was also received and under Section 112 (c) (1), gain from the exchange was required to be recognized in an amount not in excess of the cash. Part or all of the recognized gain, however, is to be taxed as a dividend to the extent that Section 112 (c) (2) is applicable.

Section 112 (c) (2) provides:

> If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913.

As we have shown under A, *supra*, the cash distribution did not exceed the earnings and profits of the corporation. Under those circumstances, we submit that, as the Tax Court held, Section 112 (c) (2) requires that the total recognized gain be taxed as a dividend.

Section 112 (c) (2) originated as Section 203 (d) (2) of the Revenue Act of 1924, c. 234, 43 Stat. 253. Its purpose was stated in H. Rep. No. 179, 68th Cong., 1st Sess., pp. 14–15 (1939–1 Cum. Bull. (Part 2) 241, 252), as follows:

> Section 203 (d):
>
> * * * * *
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> (2) There is no provision of the existing law which corresponds to paragraph (2) of subdivision (d). This subdivision provides that any amount distributed by a corporation in connection with a reorganization which has the effect of a taxable divi-

dend shall be taxed as a dividend and not as a taxable gain.

The necessity for this provision may best be shown by an example: Corporation A has capital stock of $100,000, and earnings and profits accumulated since March 1, 1913, of $50,000. If it distributes the $50,000 as a dividend to its stockholders, the amount distributed will be taxed at the full surtax rates.

On the other hand, corporation A may organize corporation B, to which it transfers all its assets, the consideration for the transfer being the issuance by B of all its stock and $50,000 in cash to the stockholders of corporation A in exchange for their stock in corporation A. Under the existing law, the $50,000 distributed with the stock of corporation B would be taxed, not as a dividend, but as a capital gain, subject only to the 12½ per cent rate. The effect of such a distribution is obviously the same as if the corporation had declared out as a dividend its $50,000 earnings and profits. If dividends are to be subject to the full surtax rates, then such an amount so distributed should also be subject to the surtax rates and not to the 12½ per cent rate on capital gain. Here again this provision prevents evasions.

S. Rep. No. 398, 68th Cong., 1st Sess., p. 15 (1939–1 Cum. Bull. (Part 2) 266, 277) is similar.

The Section has been construed in numerous cases and the settled interpretation has been that

in determining what portion of the recognized gain under Section 112 (c) (1) is to be taxed as a dividend under Section 112 (c) (2), a distribution in cash made pursuant to the plan of reorganization has the effect of a distribution of a taxable dividend to the extent that it is made out of earnings and profits accumulated after February 28, 1913; or, stated another way, if prior to the reorganization the corporation had undistributed earnings and profits available for distribution in an amount of cash not in excess of these earnings, a distribution of this cash pursuant to the plan of reorganization has the same effect, and is to be treated, as a taxable dividend. See *Love* v. *Commissioner,* 113 F. 2d 236 (C. C. A. 3d); *Campbell* v. *United States,* 144 F. 2d 177 (C. C. A. 3d); *Rose* v. *Little Inv. Co.,* 86 F. 2d 50 (C. C. A. 5th); *Commissioner* v. *Owens,* 69 F. 2d 597 (C. C. A. 5th); *Commissioner* v. *Forhan R. Corp.,* 75 F. 2d 268 (C. C. A. 2d); *Hazleton Corp.* v. *Commissioner,* 36 B. T. A. 908, petition for review dismissed January 3, 1939 (C. C. A. 9th); *Woodard* v. *Commissioner,* 30 B. T. A. 1216, petition for review dismissed April 24, 1935 (C. C. A. 3d); *Henritze* v. *Commissioner,* 28 B. T. A. 1173, 1177–1178; *Woodward* v. *Commissioner,* 23 B. T. A. 1259. The foregoing cases involved exchanges of stock in one corporation for stock of another corporation and cash, but the same principle has been applied in cases where the cash distribution was received in an exchange pursuant to a re-

capitalization of a single corporation. *J. Weingarten, Inc.* v. *Commissioner,* 44 B. T. A. 798, 808–809; *Knapp Monarch Co.* v. *Commissioner,* 1 T. C. 59, 69–70, affirmed on other grounds, 139 F. 2d 863 (C. C. A. 8th); see also the alternative holding in *McCord* v. *Commissioner,* 31 B. T. A. 342, 344.

The Tax Court followed the rule of these cases in holding here that the cash distributed in the recapitalization of Abercrombie & Fitch Company is to be taxed as a dividend under Section 112 (c) (2). It found that there were earnings and profits in January, 1937, greatly in excess of the cash payment and that the distribution of the cash therefore had the effect of the distribution of a taxable dividend. The court below held that the distribution involved in this case did not have the effect of a taxable dividend under Section 112 (c) (2), not only for the reason that there were no undistributed earnings or profits, but apparently, also because the Section is to be construed as applying only to transactions which lack bona fides (R. 50–51). The view of the court seems to have been that Section 112 (c) (2) and Section 115 (g) are equivalent provisions and that Section 112 (c) (2) is to be construed as the court construed Section 115 (g) in *Patty* v. *Helvering,* 98 F. 2d 717, and *Commissioner* v. *Quackenbos,* 78 F. 2d 156. The rule applied in these cases was that a distribution in redemption of stock, previously issued as a stock

dividend is essentially equivalent to the distribution of a taxable dividend under Section 115 (g) only when the stock dividend was not issued for a bona fide business purpose, and hence the redemption was a tax avoidance device.

The precursor of Section 115 (g) was Section 201 (d) of the Revenue Act of 1921, c. 136, 42 Stat. 227, which applied only to redemptions of stock previously issued as stock dividends. But Section 201 (g) of the Revenue Act of 1926 was enacted substantially in the form in which it appears in the Revenue Act of 1936. As amended, it embraces all distributions in redemption of stock, whether or not issued as a stock dividend, which are essentially equivalent to the distribution of a taxable dividend by reason of the time and manner in which made. Its purpose was to narrow the distinction between liquidating dividends and dividends paid from profits, so that a corporation might not by resorting to the device of stock redemption make a distribution to shareholders essentially resulting in a division of profits. *Hyman v. Helvering*, 71 F. 2d 342, 343–344 (App. D. C.), certiorari denied, 293 U. S. 570.[21]

[21] H. Conference Rep. No. 356, 69th Cong., 1st Sess., p. 30 (1939–1 Cum. Bull. (Part 2) 361–362), summarizes the purpose as follows:

"Amendment No. 1: It has been contended that under existing law a corporation, especially one which has only a few stockholders, might without resorting to the device of a stock dividend be able to make a distribution to its stock-

The view stated in *Patty* v. *Helvering, supra,* that Section 115 (g) applies only to redemptions of stock not issued for a genuine business purpose has been specifically disapproved by other courts. See *Vesper Co.* v. *Commissioner,* 131 F. 2d 200, 204 (C. C. A. 8th); *Hirsch* v. *Commissioner,* 124 F. 2d 24 (C. C. A. 9th); and *Smith* v. *United States,* 121 F. 2d 692 (C. C. A. 3d). Cf. *Flanagan* v. *Helvering,* 116 F. 2d 937 (App. D. C.). The rule governing the construction of Section 115 (g) followed in these cases was clearly stated in *Smith* v. *United States, supra,* pp. 695–696, as follows:

> * * * it is our opinion that the bona fides in a company's capitalization of its

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holders which would have the same effect as a taxable dividend. For example, assume that two men hold practically all the stock of a corporation for which each had paid $50,000 in cash, and the corporation had accumulated a surplus of $50,000 above its cash capital. It is claimed that under existing law the corporation could buy from the stockholders for cash one-half of the stock held by them and cancel it without making the stockholders subject to any tax, yet this action in all essentials would be the equivalent of a distribution through cash dividends of the earned surplus. Section 201 (g) of the House bill rewrites the provision of the existing law to make clear that such a transaction as above indicated is taxable. Obviously this subdivision does not apply in cases of a complete liquidation of all the stock of the corporation, or to one of a series of distributions in a complete liquidation which is bona fide carried out. This amendment provides that in the case of the cancellation or redemption of stock not issued as a stock dividend this subdivision shall apply only if the cancellation or redemption is made after January 1, 1926; and the House recedes."

earnings is immaterial to the applicability of Section 115 (g). If the stock is cancelled or redeemed "at such time and in such manner" as to make the cancellation or redemption essentially equivalent to a distribution of earnings or profits accumulated after February 28, 1913, the distribution is taxable as a dividend. Such is the express requirement of Section 115 (g) "whether or not such stock was issued as a stock dividend." The statute is aimed at the result. The basic criterion for the application of Section 115 (g) is "the net effect of the distribution rather than the motives and plans of the taxpayer or his corporation." *Flanagan* v. *Helvering*, App. D. C., 116 F. 2d 937, 939, 940.

The Tax Court also has found the rationale of the *Patty* case too broad for acceptance by it. *Levit* v. *Commissioner*, 43 B. T. A. 1077, 1084, petition for review dismissed *sub. nom. Clayburgh* v. *Commissioner*, 122 F. 2d 411 (C. C. A. 9th). See also Darrell, *Corporate Liquidations and the Federal Income Tax*, 89 U. of Pa. L. Rev. (1941) 907, 912-914, for a discussion of Section 115 (g), and footnote 43 thereof for a criticism of *Patty* v. *Helvering, supra.*[22]

[22] Indeed, Judge Learned Hand recognized that his reasoning and conclusions in *Patty* v. *Helvering*, 98 F. 2d 717, 719, were at odds with the decisions in *Hill* v. *Commissioner*, 66 F. 2d 45 (C. C. A. 4th); *Randolph* v. *Commissioner*, 76 F. 2d 472 (C. C. A. 8th); *Brown* v. *Commissioner*, 79 F. 2d 73 (C. C. A. 3d); *McGuire* v. *Commissioner*, 84 F. 2d 431 (C. C. A. 7th), certiorari denied, 299 U. S. 591; and *Parker* v. *United States*,

Thus it is far from clear that Section 115 (g) is to be applied only to transactions which lack an honest business purpose and were designed for tax avoidance, as the court below held in this case. But in any event, Section 112 (c) (2) is concerned with a wholly different problem and is not limited in its application to distributions in a reorganization which are devices for the distribution of earnings. As has been shown, *supra*, pp. 35–36, the uniform construction of the Section has been that a recognized gain arising from the distribution of money in a reorganization exchange has the effect of a taxable dividend to the extent that it is made from earnings.[23] The corporate reason for undertaking reorganization has not generally been discussed in the cases as a relevant factor. But see *Commissioner* v. *Forhan R. Corp.*, 75 F. 2d 268, 269 (C. C. A. 2d), where the court below itself said that Section 112 (c) (2) is not limited to cases where a reorganization is carried out for the purpose of avoiding high surtaxes. See also H. Rep. No. 179, 68th Cong., 1st Sess., pp. 14–15 (1939–1 Cum. Bull. (Part 2)

88 F. 2d 907 (C. C. A. 7th). To these cases may also be added *Robinson* v. *Commissioner*, 69 F. 2d 972 (C. C. A. 5th); and *Hyman* v. *Helvering*, 71 F. 2d 342 (App. D. C.), certiorari denied, 293 U. S. 570.

[23] This does not mean that Section 112 (c) (2) applies to all distributions of cash or other property pursuant to a plan of reorganization. Its application is predicated on the existence of undistributed earnings and profits accumulated after February 28, 1913.

241, 252), *supra*, pp. 33–34, which states that *any* amount distributed by a corporation in connection with a reorganization shall be taxed as a dividend if it has that effect. There is no suggestion in that report that the application of Section 112 (c) (2) was to be limited to cases where the transaction had no business purpose. Congress obviously had in mind bona fide reorganizations as in enacting other provisions with respect to reorganizations and exchanges.

Indeed, if a reorganization transaction had no business purpose but was a mere device for the distribution of an ordinary dividend with a view to avoiding full taxation thereon, the Commissioner would not be compelled to recognize the transaction as a reorganization at all (*Gregory* v. *Helvering*, 293 U. S. 465),[24] and would not be obliged to rely on Section 112 (c) (2) in taxing the distribution as a dividend. But in any case, the provisions of Section 112 (c) (2) plainly encompass distributions having the effect of taxable dividends made in a reorganization which is classified as such for tax purposes. Cf. *Helvering* v. *Credit Alliance Co.*, 316 U. S. 107. There is no logical basis, therefore, for restricting Section 112 (c) (2) to transactions lacking a business purpose.

[24] See *Wellhouse* v. *Commissioner*, 3 T. C. 363, 367–368, for an application of this principle to a transaction in form a recapitalization, but having no business purpose.

Furthermore, the phrase in Section 115 (g) which gave some color to the Circuit Court of Appeals' construction of that Section is lacking in Section 112 (c) (2). Section 112 (c) (2) is confined to distributions pursuant to a plan of reorganization but prescribes broadly within that class that all distributions in a reorganization representing recognized gain and having "the effect of the distribution of a taxable dividend" shall be "taxed" as a dividend to the extent of the stockholder's share of the "undistributed" earnings and profits. Section 115 (g) is confined to distributions in redemption of stock and is not concerned with reorganizations. It applies to stock redemptions only which are made "at such time and in such manner" as to make the distribution in whole or in part essentially equivalent to the distribution of a taxable dividend; in such event the amount so distributed shall be "treated" as a taxable dividend to the extent that it represents a distribution of "accumulated" earnings and profits. Thus Section 115 (g) prescribes that even though a liquidating distribution may be out of earnings, its equivalence to a taxable dividend depends on the *time and manner in which made*. But Section 112 (c) (2), as indicated by its terms and by its legislative history, and as construed by the courts, applies to any distribution in a reorganization if there are earnings and profits to cover it, without any limitation as to the time and

manner in which the distribution may have been made.

The Tax Court's determination that the distribution had the effect of the distribution of a taxable dividend was therefore predicated on a correct understanding of Section 112 (c) (2). If the issue, whether it had such effect, depended in any way on the time and manner of the distribution and circumstances other than the existence of earnings and profits sufficient to cover the distribution, it should be noted that the courts have frequently held that a finding, made pursuant to Section 115 (g), that a distribution is "essentially equivalent to the distribution of a taxable dividend" is one of fact.[25] On that theory the Tax Court's finding here that a distribution has the effect of the distribution of a taxable dividend would seem to be conclusive. Cf. *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231; *Commissioner* v. *Scottish American Inv. Co.*, decided by this Court, December 4, 1944. The taxpayer has pointed to no circumstances that would compel

[25] *Fox* v. *Harrison* (C. C. A. 7th), decided November 18, 1944 (1944 P-H, par. 62,777); *Vesper Co.* v. *Commissioner*, 131 F. 2d 200 (C. C. A. 8th); *Hirsch* v. *Commissioner*, 124 F. 2d 24 (C. C. A. 9th); *Smith* v. *United States*, 121 F. 2d 692 (C. C. A. 3d); *McGuire* v. *Commissioner*, 84 F. 2d 431 (C. C. A. 7th), certiorari denied, 299 U. S. 591; *Brown* v. *Commissioner*, 79 F. 2d 73 (C. C. A. 3d); *Commissioner* v. *Champion*, 78 F. 2d 513 (C. C. A. 6th); *Hyman* v. *Helvering*, 71 F. 2d 342 (App. D. C.), certiorari denied, 293 U. S. 570.

the Tax Court to find that the distribution could not have had such an effect.

To be sure, the taxpayer argued below and in the brief in opposition that the distribution had the effect, not of a taxable dividend but of a partial liquidation since the recapitalization resulted in a reduction in the capitalization of the company. It is significant that the taxpayer does not argue that the distribution was in reality a liquidating dividend to be taxed under Section 115 (c) for the reason that it realizes, as the court below evidently did not, that resort to that Section would not reduce the tax (See Argument, *infra*, pp. 54–56). It wishes to retain whatever advantages are to be obtained from treating the transaction as an exchange pursuant to a reorganization but at the same time to argue that since the capitalization of the company is reduced (see footnote 29, *infra*), the distribution had the effect of a liquidation and the Tax Court was precluded from holding that any part of the gain could be taxed as a dividend.

Neither Section 112 (c) (1) nor Section 112 (c) (2) is either apparently or logically concerned with the effect of the transaction on the capital of the company. They are concerned wholly with the profit made by the taxpayer on his own investment as the result of the exchange. The fact that his interest in the capital of the corporation may have been reduced does not limit the gain to be taxed under Section 112 (c) (1) and would seem

to be equally irrelevant in determining whether part of the profit should be taxed as a dividend.[26] But if it were relevant, it would also be pertinent to inquire what the reduction in capitalization represents and in this case it seems clear that the reduction does not exceed the non-taxable stock dividends issued in earlier years (see footnote 29, *infra*) which on the books of the company but not for tax purposes capitalized the earnings of the company. Moreover, one of the appropriate tests for determining whether a liquidating distribution is essentially equivalent to the distribution of a taxable dividend is that the corporation did not manifest any policy of contraction. *Flanagan* v. *Helvering*, 116 F. 2d 937, 939 (App. D. C.). In this case, so far as the record shows, the corporation continued as a going concern with no apparent intention to curtail its business, even

[26] We point out hereinafter why the distribution here was not a distribution in partial liquidation within the meaning of Section 115 (i). But even if it is assumed *arguendo* that the effect of the distribution could be construed as that of a partial liquidation, it would not follow that the distribution could not have the effect of a distribution of a taxable dividend. Section 115 (g) which is wholly concerned with redemptions and hence with distributions in partial liquidation recognizes that such a distribution may be the "equivalent" of the distribution of a taxable dividend as do the cases decided thereunder. This is so even though the distribution results in reduced capitalization. See, for example, *Vesper Co.* v. *Commissioner*, 131 F. 2d 200 (C. C. A. 8th); *Hirsch* v. *Commissioner*, 124 F. 2d 24 (C. C. A. 9th); cf. *Wilcox* v. *Commissioner*, 137 F. 2d 136 (C. C. A. 9th).

though its capitalization was reduced. As has been shown, *supra*, pp. 34–43, the test for determining whether a distribution has the effect of a taxable dividend under Section 112 (c) (2) is the existence of earnings and profits. But if the same criteria could be used in construing Section 112 (c) (2) as in construing Section 115 (g), the fact that the business was not curtailed would be relevant as showing that the cash distribution had the effect of a taxable dividend, rather than a partial liquidation.

The Tax Court has recognized that a distribution made in an exchange pursuant to a recapitalization, the result of which was to reduce the capitalization of the corporation, had the effect of a taxable dividend, since it was made out of earnings. *McCord* v. *Commissioner*, 31 B. T. A. 342, 344. In any case, the basic test under Section 112 (c) (2) is whether the cash given in partial exchange for the stock represented earnings. There is nothing in any of the cases indicating that the result under that Section depends on the form the reorganization takes or on the effect on the capitalization of the reorganizing corporation. There is therefore no basis for the argument that a distribution of money out of accumulated earnings does not have the effect of a taxable dividend in a situation where the capital of the corpora-

tion is reduced.[27] But in any event, if the distribution does not have the effect of the distribution of a taxable dividend but does have the effect of a distribution in partial liquidation, it should be treated as a distribution in partial liquidation. The tax effect of this treatment is discussed, *infra*, pp. 54–56.

In its brief in opposition (p. 14), the taxpayer poses the hypothetical case of a stockholder who had a loss on the transaction involved in this case and points to inequities which might result in such case if the cash distribution is held to have the effect of a dividend. We do not see how such a holding in this case could create inequities in the supposed case. The loss sustained by such a taxpayer on the exchange would not be recognized under the provisions of Section 112 (b) (3) and (e). Section 112 (c) (1) and (2) relate only to *gains* on exchanges involving other property and money. Since the taxpayer in the

[27] Taxpayer also argued below that the distribution could not have the effect of a dividend because under state law the corporation could not have paid a dividend while its books showed a deficit. This argument disregards the fact that the corporation by means of the recapitalization did effect a distribution of accumulated earnings to its preferred stockholders. Although the distribution was not in form a dividend, it had the effect of one. Cf. *Vesper Co.* v. *Commissioner*, 131 F. 2d 200 (C. C. A. 8th), in which a deficit corporation was forbidden by state law to pay dividends; nevertheless a distribution in redemption of its stock was held to be essentially equivalent to the distribution of a taxable dividend to the extent that it was made from earnings.

supposed case had a loss, Section 112 (c) (2) would not apply to him. Because he had no gain, the cash distribution would not be taxed to him as a dividend, regardless of whether or not it has the effect of a distribution of earnings and profits of the corporation to him. The taxpayer's argument overlooks the fact that it is being taxed, not on a dividend, but on a gain, which is taxed as though it had been a dividend.

Since there were earnings and profits out of which the cash distribution is deemed to have been made (see Section 115 (b), Appendix A, *infra*, p. 65) and since the bona fides of the transaction is irrelevant under Section 112 (c) (2) if earnings are available for distribution, we submit that the distribution of the cash pursuant to the plan of reorganization had the effect of and is to be taxed as a dividend.

C. *The distribution was not a partial liquidation but, even if it were, the tax would not be less than that determined by the Tax Court.*—The foregoing argument would dispose of the case if it were not for the fact that the Circuit Court of Appeals also rested its decision on an alternative theory (R. 51). This theory was that even though there were earnings and profits available for distribution, the distribution of the cash was a distribution in partial liquidation under Section 115 (c) and (i) and that it is properly chargeable to

capital account under the decision of this Court in *Foster* v. *United States*, 303 U. S. 118, rehearing denied, 303 U. S. 667. This holding seems to be the result of taxpayer's contention that the distribution had the effect of a partial liquidation. The Government's position with respect to the Court's alternative holding is (1) that there was not a partial liquidation and, in any event, that the provisions of Section 115 (i) (Appendix A, *infra*, pp. 67–68) have no application to a distribution, even though liquidating, made pursuant to a reorganization; (2) that if the transaction was a partial liquidation, the gain on the transaction, to the extent recognized, is taxable in full under Section 115 (c) regardless of the holding period; and (3) that the question decided in the *Foster* case is not presented here.

(1) The parties were in agreement before the Tax Court and the Circuit Court of Appeals that the taxability of the distribution was controlled by the provisions of Section 112 (c), since the distribution was pursuant to a plan of reorganization. The lower court's injection of Section 115 (i) into the case as determining the nature of the transaction would seem, therefore, not to be warranted. In any event, the Section does not apply to the distribution involved in this case.

In the first place, the transaction does not fall within the definition of a partial liquidation con-

tained in Section 115 (i), even if its reorganization aspect be disregarded. That Section prescribes that amounts distributed in partial liquidation mean—

> a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

The last part of the definition does not apply because the distribution in this case was not one of a series of distributions. The first part of the definition does not apply because the distribution in January, 1937, was not in complete cancellation of a *part* of the stock. If it was any sort of liquidating distribution, it was a complete cancellation of *all* the stock. Under the plan of recapitalization, all the old preferred stock was exchanged for new preferred, new common, and cash, and all the old common stock was exchanged for new common stock (R. 12–13). Thus the retirement extended to all classes of outstanding old stock rather than merely a part thereof. This situation is outside the definition of partial liquidation.[25] The fact that as a result of the exchange the authorized capitalization of the com-

[25] Nor was there a complete liquidation as defined in Section 115 (c) because there was no plan of liquidation. On the contrary, the intention was to continue the corporation as a going concern.

pany was reduced [29] does not alone seem sufficient to place the transaction within the definition of partial liquidation, since all, and not merely a part, of the old stock was retired and new stock of a lesser par value was substituted therefor.

Hammans v. *Commissioner,* 121 F. 2d 4 (C. C. A. 2d) cited by the court below, is distinguishable. There the company had preferred and common stock outstanding. Under a plan of exchange all the preferred stock was exchanged for common stock and cash, but the outstanding common stock was not exchanged or retired. Thus in that case there was truly a cancellation of only a part of the stock and the transaction was held to come

[29] Prior to the recapitalization the authorized stock was (R. 14, 16):

20,000 shares of preferred, par $100	$2,000,000
100,000 shares of common, no par value but having a stated value of $5	500,000
Total capitalization	2,500,000

After the reorganization the authorized stock was (R. 14):

21,000 shares of preferred, par $75	$1,575,000
100,000 shares of common, par $1	100,000
Total capitalization	1,675,000

The record does not give figures showing the issued and outstanding stock after the recapitalization although it does show that 17,973 shares of preferred and 71,800 shares of common were outstanding prior to the recapitalization (R. 12). These would have a stated value of $2,156,300. It will be recalled that the corporation had issued common stock dividends of $161,700 and preferred stock dividends of $682,400 (R. 37). The reduction in capitalization would evidently not exceed these amounts.

within the statutory definition of a partial liquidation; consequently 100% of the gain was taxed under Section 115 (c) of the Revenue Act of 1936. The transaction in the *Hammans* case was not a reorganization as in the instant case.[30]

But even if it is assumed *arguendo* that the distribution in this case falls within the statutory definition of a partial liquidation, the partial liquidation was but one of the steps in a recapitalization. The determinative factor is that the transaction, viewed as a whole, was a reorganization as defined by Section 112 (g) and the distribution in retirement of the old stock was one of the incidents of the plan of reorganization. The Tax Court so treated it and the Circuit Court of Appeals was not at liberty to single out the retirement and give separate effect to it as a partial liquidation. *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231.

A distribution of some kind in cancellation of stock is a usual incident of every reorganization

[30] *Kelly* v. *Commissioner*, 97 F. 2d 915 (C. C. A. 2d), and *Malone* v. *Commissioner*, 128 F. 2d 967 (C. C. A. 5th), both involved a corporation which had only one class of stock. Each stockholder surrendered his stock for half as many shares of the *same* stock plus cash (and stock in another corporation in the *Kelly* case): These transactions were held to be partial liquidations as defined by statute because one half (a part) of the outstanding stock was redeemed. The cases did not involve a reorganization and they are otherwise distinguishable from the instant case. They were not cases where *all* the old stock was retired and new kinds of stock were substituted therefor as in the case at bar.

plan, but the transaction nevertheless is classified as a reorganization. It is completely immaterial that the distribution, as a result of which stock is cancelled, might literally satisfy the definition of a distribution in partial liquidation contained in Section 115 (i). Once it is determined that a distribution of money or other property is made in pursuance of a plan of reorganization, the method of taxing the distribution is fixed by Section 112 (c) (1) and (2). This Section is complete in itself and controls where a reorganization is involved. This is apparent from the decision in *Love* v. *Commissioner*, 113 F. 2d 236 (C. C. A. 3d). There, although the cash distribution made pursuant to the reorganization was referred to as a liquidating dividend, the provisions of Section 112 (c), relating to reorganizations, were applied to the exclusion of the sections dealing with distributions in liquidation. To the same effect see *Commissioner* v. *Owens*, 69 F. 2d 597 (C. C. A. 5th); *Hazleton Corp.* v. *Commissioner*, 36 B. T. A. 908, petition for review dismissed January 3, 1939 (C. C. A. 9th); *Woodard* v. *Commissioner*, 30 B. T. A. 1216, 1229, petition for review dismissed April 24, 1935 (C. C. A. 3d).[31] See also *Helver-*

[31] Cf. the statement made in *Knapp Monarch Co.* v. *Commissioner*, 1 T. C. 59, 68, affirmed on other grounds, 139 F. 2d 863 (C. C. A. 8th): "The liquidation of a corporation is not in and of itself a reorganization and standing alone the taxability of distributions in liquidation are determined under section 115 (c), and the nonrecognition provisions of section 112 are not applicable."

ing v. *Leary*, 93 F. 2d 826 (C. C. A. 4th); *Helvering* v. *Schoellkopf*, 100 F. 2d 415 (C. C. A. 2d); *Commissioner* v. *Kolb*, 100 F. 2d 920 (C. C. A. 9th); and *Commissioner* v. *Food Industries*, 101 F. 2d 748 (C. C. A. 3d), which did not involve Section 112 (c) (2), but in which it was held that a distribution, in a reorganization, of earnings accumulated after February 28, 1913, in partial cancellation of stock resulted in a taxable dividend rather than a liquidating distribution.

Thus we submit that the distribution involved in this case is to be taxed as provided in Section 112 (c), without reference to the provisions of Section 115 (c) and (i).

(2) As an alternative, if the view of the lower court that the distribution was one in partial liquidation as defined in Section 115 (i) be accepted *arguendo*, we submit that the method of taxing the distribution is determined by the provisions of Section 115 (c), and that the gain on the transaction was taxable in full under that Section.

Section 115 (c) provides in part as follows:

> * * * amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of sec-

tion 117 (a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation.

In this case the old stock which was liquidated had a cost basis of $210,000 (R. 38). After the basis of this old stock is fully recouped out of the stock and cash, having a value of $349,740 (R. 9), given in exchange, there remains a gain on the exchange of $139,740 determined under Section 111 (Appendix A, *infra,* p. 63), which is to be recognized to the extent provided in Section 112. The general rule is stated in Section 112 (a) which provides that upon the exchange of property, the entire amount of the gain is to be recognized, except as thereinafter provided. None of the exceptions appears to apply if the transaction is viewed solely as a partial liquidation. Hence the gain would be recognized to its full extent of $139,740. But if the transaction be viewed as a reorganization as well as a liquidation, Section 112 (b) (3) and (c) (1) would apply to prevent the recognition of gain except to the extent of the cash, or $45,240. Whether the recognized gain be $139,740 or $45,240, under the express provisions of Section 115 (c) the amount taxed is not to be limited by Section 117 (a) (Appendix A, *infra,* p. 68), but 100% of the gain is to be taken into account in computing income.

Thus, under the alternative theory of the Circuit Court of Appeals, the recognized gain on the exchange, whether it be $139,740 or $45,240, must be taxed in full. The result is that the taxpayer's income under this theory will include an amount at least equal to, and possibly greater than, the gain includible as a result of taxing the distribution as a dividend under Section 112 (c) (2). The tax liability of the taxpayer is therefore not decreased in any event, if the transaction be treated as a distribution in liquidation.

The Circuit Court of Appeals failed to follow through on its alternative holding that the distribution was in partial liquidation by applying the provisions of Section 115 (c). But we submit that if the exchange in this case was a partial liquidation, or even if it had the "effect" of a partial liquidation rather than the effect of a taxable dividend as the taxpayer has argued, Section 115 (c) prescribes the rules controlling the recognition and amount of the taxable gain. Since application of this Section would not result in decreasing the amount of gain taxed, and consequently the tax liability as determined under Section 112 (c) (2), the decision of the Tax Court must be affirmed.

(3) In connection with its holding that the distribution is one in partial liquidation, the court below stated that under *Foster* v. *United States*, 303 U. S. 118, rehearing denied, 303 U. S. 667,

the cash distribution was properly chargeable to capital account, rather than to earnings and profits. In the *Foster* case, however, the question was as to the effect of a distribution in partial liquidation on earnings and profits for the purpose of determining the taxability of a later distribution. Section 115 (c) of the Revenue Act of 1928, which is substantially the same as Section 115 (c) of the Revenue Act of 1936 involved in this case provided in part:

> In the case of amounts distributed in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) * * * for the purpose of determining the taxability of subsequent distributions * * *[32]

Assuming *arguendo* that the distribution was one in partial liquidation and was not a distribu-

[32] The language "within the meaning of subsection (b) * * * for the purpose of determining the taxability of subsequent distributions" was deleted in Section 115 (c) of the 1936 Act. The House Ways and Means Subcommittee Report on the Revenue Bill of 1936, dated March 26, 1936, 74th Cong., 2d Sess., p. 6, states:

"LIQUIDATING DIVIDENDS.—In computing undistributed net income [for purposes of a proposed tax on undistributed income of corporations], it is recommended that the corporation be allowed a deduction for any part of liquidating dividends properly allocable to earnings and profits, but no deduction shall be given for the portion thereof properly chargeable to capital account."

It is clear therefore that the clause was deleted so that the

tion in a reorganization to be governed by the provisions of Section 112 (c) (2), we submit that it is immaterial to what account the distribution should be charged on the company's books. So narrowed, the case involves only the question of the amount of the gain upon the liquidating distribution which is to be taxed to the taxpayer as a stockholder, as provided in Section 115 (c). Its gain is represented by the excess of the amount it received, in stock and cash, on the exchange over its basis for the stock surrendered. This gain is taxable income because the capital investment or basis for the stock surrendered has been recovered, irrespective of whether the corporation charges the liquidating distribution to earnings and profits or to capital account.[33] The manner in which the corporation accounts for the distribution can not affect the amount of gain realized by a stockholder. See Sections 115 (c), 111, and 112, and *Hellmich* v. *Hellman*, 276 U. S. 233.

Even if the question were presented in this case as to whether the distribution was chargeable to

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Section would comprehend the situation in the quoted language, as well as situations involving the taxability of subsequent distributions. The change did not affect the method of taxing the stockholder on the liquidating dividend itself as prescribed in preceding sentences of Section 115 (c) of both statutes.

[33] The amount of the corporation's earnings and profits is material in this case only as determining whether the cash distribution had the effect of a taxable dividend under Section 112 (c) (2).

capital or earnings, the case of *Foster* v. *United States,* 303 U. S. 118, would not in any event be applicable. That case involved a corporation which had earnings accumulated prior to March 1, 1913,[34] and earnings accumulated subsequent thereto. The question was whether a distribution in retirement of stock was properly chargeable to pre-1913 earnings or post-1913 earnings for the purpose of determining whether a subsequent distribution was a dividend paid out of accumulated earnings or a return of capital. The opinion specifically limits its scope to "stock purchases of the type" there involved (p. 122) and does not purport to lay down a general rule that all distributions in partial liquidation are properly chargeable to capital account. See *Helvering* v. *Jarvis,* 123 F. 2d 742 (C. C. A. 4th). The lower court therefore misinterpreted the *Foster* decision in holding (R. 51) that it states a general rule in this respect. Cf. *Helvering* v. *Credit Alliance Co.,* 316 U. S. 107. In the instant case there are no issues with respect to whether the liquidating distribution is chargeable to pre-1913 earnings or post-1913 earnings or as to the effect of the distribution on the taxability of subsequent distributions by the corporation. The *Foster* case is

[34] The "capital account" is generally understood to include earnings accumulated prior to March 1, 1913, in addition to capital stock. *Helvering* v. *Credit Alliance Co.,* 316 U. S. 107, 111.

consequently not apposite to the factual situation in this case.

Since it is irrelevant to the issues before the Court, it is not deemed necessary to discuss whether the cash distribution, if it is held to be a distribution in partial liquidation, is properly chargeable to earnings and profits or capital account. It is enough that, under Section 115 (c), the taxpayer, receiving a distribution in partial liquidation, is taxable on 100% of the resulting gain.

CONCLUSION

The judgment of the Circuit Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

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FEBRUARY 1945.

APPENDIX A

1. *Authorities on the Jurisdictional Question*

Act of February 13, 1925, c. 229, 43 Stat. 936:

> SEC. 8. (a) That no writ of error, appeal, or writ of certiorari, intended to bring any judgment or decree before the Supreme Court for review shall be allowed or entertained unless application therefor be duly made within three months after the entry of such judgment or decree, excepting that writs of certiorari to the Supreme Court of the Philippine Islands may be granted where application therefor is made within six months: *Provided,* That for good cause shown either of such periods for applying for a writ of certiorari may be extended not exceeding sixty days by a justice of the Supreme Court.
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> * * * * * *

(28 U. S. C. 350.)

Rules of the United States Circuit Court of Appeals for the Second Circuit:

> Rule 30. *Taxing Costs—Order—Mandate.*
>
> 1. Upon the filing of any decision by this court the clerk shall forthwith, or at any later time, if the court thinks justice requires it, enter the proper order, and will thereupon prepare and tax the bill of costs, giving to the parties reasonable time to file with him their proposed orders and bill of

costs, with proof of service of the same upon their opponents.

2. A mandate may issue at any time on order of this court, but unless otherwise ordered shall issue at the expiration of fifteen days from the filing of the opinion of this court in the clerk's office unless delayed by the filing of the petition for rehearing.

3. If application for certiorari from the Supreme Court be made, application to stay the mandate pending such certiorari shall be made only to this court, except in vacation when such application may be made to any judge of this court. During recesses, any judge of this court may grant an order to show cause (with stay) why the issuance of mandate should not be withheld, making however, such order to show cause returnable at the next motion day of this court.

If a stay be granted, it shall not be for more than 30 days, at which time the stay shall expire and the mandate issue forthwith.

Provided that if within 30 days there is filed with the clerk of this court the certificate of the clerk of the Supreme Court of the United States that the certiorari petition, record and briefs have been filed, and proof by affidavit of notice thereof under paragraph 3 of Rule 38 of the Supreme Court thereupon the stay shall continue until the final disposition of the case by the Supreme Court. Immediately upon the filing of a copy of an order denying the writ, the clerk of this court shall issue the mandate.

2. *Statutes and Regulations Involved in the Question on the Merits*

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the

plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(c) *Gain from Exchanges not Solely in Kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) [As amended by Sec. 213 (g) (1) of the Revenue Act of 1939, c. 247, 53 Stat. 863, 871] The term "reorganization" means

* * * or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

* * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) [As amended by Sec. 205 of the Revenue Act of 1937, c. 815, 50 Stat. 813] *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full pay-

ment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117 (a), 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock div-

idend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in

complete cancellation or redemption of all or a portion of its stock.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 115–11. *Effect on earnings or profits on certain tax-free exchanges and tax-free distributions.*—If, under the law applicable to the year in which any transfer or exchange of property after February 28, 1913, was made (including transfers in connection with a reorganization or a complete liquidation under section 112 (b) (6) and inter-company transfers of property during a period of affiliation), gain or loss was not recognized (or was recognized only to the extent of the property received other than that permitted by such law to be re-

ceived without the recognition of gain), then proper adjustment and allocation of the earnings or profits of the transferor shall be made as between the transferor and transferee corporations.

The general rule provided in section 115 (b) that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to:

(1) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, to its shareholders of stock or securities in such corporation or in another corporation a party to the reorganization—

(A) in any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112 (g) of the Revenue Act of 1932); or

(B) in any taxable year (beginning before January 1, 1936, or on or after such date) in exchange for its stock or securities (see section 112 (b) (3))

if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(2) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

A distribution described in paragraphs (1) and (2) above does not diminish the earnings or profits of any corporation. In such

cases, the earnings or profits remain intact and available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange.

For the purposes of this article, the terms "reorganization" and "party to the reorganization" shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1932, and for any taxable year beginning after December 31, 1933, and before January 1, 1936, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934.

APPENDIX B

1. *Letter from taxpayer's counsel to the Clerk of the Circuit Court of Appeals for the Second Circuit, dated January 15, 1945*

HOLT S. MCKINNEY
Counsellor at Law
120 Broadway
NEW YORK CITY

JANUARY 15th, 1945.

HONORABLE ALEXANDER M. BELL, *Clerk,*
United States Circuit Court of Appeals
Second Circuit, U. S. Courthouse,
Foley Square, New York 7, N. Y.

Re—*Estate of Edward T. Bedford, Title Guarantee & Trust Co., Executor* v. *Commissioner of Internal Revenue*

DEAR MR. BELL: According to the docket entries in the above-entitled case, an Order for Mandate was issued by the Circuit Court of Appeals, Second Circuit, in this case on August 29, 1944.

May we respectfully inquire whether said Order for Mandate was entered pursuant to an express direction of the Court, or was it entered by the Clerk pursuant to Rule 30, paragraph 2, of the Rules of the United States Circuit Court of Appeals for the Second Circuit, without further action or order by the Court.

May we also inquire whether said Order for Mandate, issued on August 29, 1944, is entered in any bound record of the Court, or is it simply contained on a loose sheet of paper kept in a filing cabinet along with other papers and correspondence relating to the case.

Your advice regarding the above will be greatly appreciated.

Respectfully,

(Sgd.) H. S. McKinney.

HSM:MBH

2. *Letter from the Clerk to taxpayer's counsel, dated January 15, 1945*

January 15th, 1945.

Holt S. McKinney, Esq.
120 Broadway
New York, N. Y.

Estate of Bedford, et al. v. *Commissioner of Internal Revenue*

Dear Mr. McKinney: In reply to yours of the 15th inst., the order for mandate in the above-entitled case was entered by the Clerk under Rule 30, paragraph 2, on August 29, 1944.

The order for mandate was made on a printed form order for mandate of legal cap size and filed together with the other papers in this case. A copy is made and kept in the permanent minute book of this Court.

Respectfully,

Alexander M. Bell,
Clerk.

3. *Letter from the Solicitor General to the Clerk, dated January 20, 1945*

JANUARY 20, 1945.

A. M. BELL, Esq.
Clerk, U. S. Circuit Court of
Appeals for the Second Circuit
New York, New York

Re: *Estate of Edward T. Bedford, Title Guarantee and Trust Company, Executor* v. *Commissioner of Internal Revenue*

DEAR MR. BELL: On August 8, 1944, the Circuit Court of Appeals for the Second Circuit filed its opinion and on August 29, 1944, entered its Order for Mandate in the above case. On November 29, 1944, the Government filed a petition for certiorari with the Supreme Court on behalf of the Government.

The brief in opposition to the petition filed by the executor raises the question whether the petition was filed within three months after entry of judgment. In view of Rule 30 of the Second Circuit requiring that an appropriate order be entered "forthwith" following the decision of a case, it is contended that the Clerk's entry of August 8, following the filing of the opinion, constituted the judgment.

On January 8, 1945, the Supreme Court granted certiorari, but requested the parties to discuss in their briefs and on oral argument the question whether the application for certiorari was within the time provided by law.

In presenting to the Supreme Court the merits of the question which has been raised, it would

be very helpful to receive any information you may be able to send me concerning the practice in the Second Circuit and the understanding with regard to what constitutes the court's judgment, in addition to that which appears in the brief in opposition which raised the question. I am enclosing a copy of this brief for your information.

Sincerely yours,

CHARLES FAHY,
Solicitor General.

cc-Erwin N. Griswold, Esq.,
c/o Holt S. McKinney,
122 E. 42nd Street,
New York City, N. Y.

4. *Letter from the Clerk to the Solicitor General, dated January 23, 1945*

UNITED STATES CIRCUIT COURT OF APPEALS
Second Circuit
United States Courthouse
Foley Square
NEW YORK 7

Alexander M. Bell, Clerk.

JANUARY 23, 1945.

Hon. CHARLES FAHY,
Solicitor General,
Washington, D. C.

Estate of Bedford, etc. v. *Commissioner*

DEAR MR. FAHY: In reply to yours of the 20th inst., regarding the timeliness of the filing of the petition for a writ of certiorari herein, I set forth below the helpful information you seek. I have

answered each paragraph of the respondent's brief, beginning with page 4 to and including page 9.

The court's opinion was handed down on August 8, 1944.

The order for mandate which is the judgment of this court was entered on August 29, 1944. The mandate was issued on August 29, 1944.

The petition for a writ of certiorari was filed on time, as the judgment of this court was entered on August 29, 1944. The order for mandate was the judgment of this court as a reading of the order clearly discloses. ("* * * it is *now* hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed.") No prior action of this court was its judgment. Surely, it cannot be contended that the opinion of this court is the judgment.

The docket entry made on August 8, 1944, is identical to that made in all cases (recording of the opinion) when the decision is rendered, whether the court or judge writing concludes the opinion with the words "is reversed", "should be reversed", or what have you. The entry is made briefly to indicate when this court decided the case what this court did to the lower court's judgment and who wrote the opinion. The argument made that the court entered the judgment on August 8, 1944, by concluding its opinion with the words "The order of The Tax Court is reversed" is negated by the rules of and by the practice in this court, and by the wording of the opinion in the first paragraph thereof: "We think the de-

cision of The Tax Court adjudging a deficiency of $13,887.24 *should be* reversed."

The paper filed on August 29, 1944, is the judgment of this court despite that it is called the order for mandate. It is so called because all judgments on decisions of all appeals from lower courts contain a paragraph ordering the issuance of a mandate. Its function is not alone to order the issuance of a mandate. That is its secondary purpose as a reading of the paragraph ordering the issuance of the mandate shows: "It is *further* ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this *decree.*" The paper called order for mandate recites that it is the decree of this court.

The characterization of the order for mandate or judgment or decree as a loose sheet of paper is at best a misleading statement. I enclose herewith a copy of a letter from Mr. McKinney relating thereto and mine in answer. The order for mandate in any case is kept with the original papers in that case, which include the original record, the original opinion, stipulations, etc., but no correspondence. An opinion of the court written on a single sheet of paper wouldn't be characterized as a loose sheet of paper. The Clerk of this court does not enter judgments at what he considers to be a convenient time. Judgments are entered here under Rule 30, paragraph 1. By the court's instruction judgments are entered at the expiration of fifteen days from the filing of the opinion. The entry of the order or judgment is not a mere ministerial act. The court has delegated its power to do so to the Clerk. The Deputy Clerk is empowered to act

for the Clerk in his absence, and such was the case here when the Clerk was away for a few days. The docket entry of August 8, 1944, was a recording of the opinion.

No judgments are entered forthwith in this court, except by direct instruction of the court. On the contrary, the Clerk has been instructed by the court to enter judgments at the expiration of fifteen days from the handing down of opinions. No order was entered here on August 8, 1944. Rule 30 of this court, together with the court's directions thereunder is not similar to the last sentence in Rule 58 of the Rules of Civil Procedure, because it is not meant to be.—

No contrast can be made between "forthwith" in paragraph 1 and "fifteen days" in paragraph 2 of Rule 30, because the court for some time past has thought that justice requires the judgment to be entered at the expiration of fifteen days from the date of the opinion.

Under paragraph 3 of Rule 30, the issuance of a mandate is stayed and not the entry of the order for mandate. In such cases, orders for mandate are and must be entered, otherwise there would be no judgment to review by petition for writ of certiorari. No record can be or ever is certified for use in petitioning for a writ unless the order for mandate is entered. The order for mandate is entirely different from the mandate and the two are not to be confused.

It is not a carelessly accepted notion that the order for mandate constitutes the judgment. On the contrary it has always been the expressed intent that it be the judgment.

The period for review of this court's decisions is not different from any of the other circuit courts of appeals. The period is the same; three months from the entry of the judgment of the court. The Department of Banking v. Pink case ~~is not at all similar to the problem here. There courts of appeals. The period is the same; three~~ no question here as to an entry of an order on mandate (same as state court remittitur) by the district court.

The judgment is not entered here at the convenience of the Clerk or his Deputy, but at the time as generally directed by the court.

Sincerely yours,

(Sgd.) ALEXANDER M. BELL,
Alexander M. Bell, *Clerk.*

5. *Letter from taxpayer's counsel to the Clerk, dated January 29, 1945*

HUNT, HILL & BETTS
Counsellors at Law—Proctors in Admiralty
Equitable Building
120 Broadway
NEW YORK 5

JANUARY 29, 1945.

HON. ALEXANDER M. BELL, *Clerk,*
United States Circuit Court of Appeals,
Second Circuit, U. S. Courthouse,
Foley Square, New York 7, N. Y.

DEAR MR. BELL: In connection with the case of *Commissioner of Internal Revenue* v. *Estate of Edward T. Bedford*, now pending before the Supreme Court, and your letter of January 23, 1945,

to the Solicitor General, will you please give me the answers to the following questions:

1. Has the Circuit Court of Appeals for the Second Circuit, by any sort of formal order, declared or ordered that it is its conclusion that justice requires that in all cases the judgment be entered at the expiration of fifteen days from the date of the opinion? If so, where is that order recorded, and what is its date and text?

2. In the eighth paragraph of your letter to the Solicitor General, you state that "the Clerk has been instructed by the court to enter judgments at the expiration of fifteen days from the handing down of opinions". Will you please state the date and text and place of recording of any such instructions, or any other basis there may be for the statement in your letter?

3. If there were such instructions, why were they not complied with in this case? I call your attention to the fact that the opinion was filed and docket entry was made in this case on August 8, 1944; while the order for mandate was entered on August 29, 1944, a period of twenty-one days. In the case of *International Standard Electric Corp.* v. *Commissioner*, now pending before the Supreme Court, the period was twenty-nine days.

4. In the case of *Estate of Edward T. Bedford* v. *Commissioner*, in which the opinion was filed in your court on August 8, 1944, did the court itself, meaning the judges thereof, or any of them, by any formal action of any sort, make or sign or initial any order or take any action in connection with the case after August 8, 1944, and on or before August 29, 1944? In particular, was the order for mandate, entered on August

29, 1944, entered pursuant to any specific order of the court made with reference to that case? If so, where is such order filed or recorded, and what judge or judges made it, and on what day?

These questions have been prepared carefully and specifically, and we would appreciate specific answers, without argument, to the questions as we have put them.

Respectfully,

(Sgd.) H. S. McKinney.

HSM: MBH

6. *Letter from the Clerk to taxpayer's counsel, dated January 31, 1945*

UNITED STATES CIRCUIT COURT OF APPEALS
Second Circuit
United States Courthouse
Foley Square
NEW YORK 7

JANUARY 31, 1945.

HOLT S. McKINNEY, Esq.,
120 Broadway, New York, N. Y.

DEAR MR. McKINNEY: In reply to yours of the 29th inst., orders for mandate are entered and mandates issued in conformity with the rules of this court.

At the expiration of fifteen days from the filing of the opinion of this Court, a bill for entering the order and issuing the mandate was mailed to you. These services were rendered when the bill was paid. The same is true of *International Standard Electric Corporation* v. *Commissioner*.

Very truly yours,

(signed) ALEXANDER M. BELL, *Clerk*.

7. Letter from taxpayer's counsel to the Clerk, dated February 3, 1945

FEBRUARY 3, 1945.

Hon. ALEXANDER M. BELL, *Clerk,*
United States Circuit Court of Appeals,
Second Circuit, U. S. Courthouse,
Foley Square, New York 7, N. Y.

DEAR MR. BELL: I have your letter of January 31, 1945, in connection with the case of *Commissioner of Internal Revenue* v. *Estate of T. Bedford,* now pending before the Supreme Court. But since you did not include in your letter of January 31st the answers to the specific questions we asked in our letter of January 29th, will you kindly advise us if we are correct in assuming:

1. The Circuit Court of Appeals for the Second Circuit *has not,* by any sort of formal order, declared or ordered that it is its conclusion that justice requires that in all cases the judgment be entered at the expiration of fifteen days from the date of the opinion.

2. That the only instructions to the Clerk by the court to enter judgments at the expiration of fifteen days from the handing down of opinions is that contained in rule 30, paragraph 2, of the rules of the United States Circuit Court of Appeals for the Second Circuit.

3. That the Order for Mandate in the instant case, and in the case of the *International Standard Electrical Corporation* v. *Commissioner* now on appeal to the Supreme Court, was entered by the Clerk of said Court when the respective bills for services were paid and that the entry of said

order in each case was made dependent upon the payment of the bill for services.

4. In the case of *Estate of Edward T. Bedford* v. *Commissioner,* in which the opinion was filed in your Court on August 8, 1944, the Court itself, meaning the judges thereof, or any of them, *did not* by any formal action of any sort, make or sign or initial any order or take any action in connection with the case after August 8, 1944, and on or before August 29, 1944.

5. The Order for Mandate, entered on August 29, 1944, in the above-mentioned case of *Estate of Edward T. Bedford* v. *Commissioner,* was not entered pursuant to any specific order of the Court made with reference to that case.

Your further advice regarding the above will be greatly appreciated.

Respectfully,

H. S. McKinney.

HSM: MBH

Copy to Hon. Charles Fahy, Solicitor General.

8. *Letter from the Clerk to taxpayer's counsel, dated February 6, 1945*

UNITED STATES CIRCUIT COURT OF APPEALS

Second Circuit

United States Courthouse

Foley Square

NEW YORK 7

FEBRUARY 6, 1945.

HOLT S. MCKINNEY, Esq.
120 Broadway, New York City.

Commissioner v. *Bedford*

DEAR MR. MCKINNEY: In reply to yours of the 3rd inst., the court some time back directed the present clerk's predecessors in office to enter judgment at the expiration of fifteen days. The fifteen-day period affords counsel for the losing party an opportunity to file a petition for rehearing.

Very truly yours,
(signed) ALEXANDER M. BELL, *Clerk*.

APPENDIX C

1. *Sample of letter mailed to the Clerk of each Circuit Court of Appeals with the exception of the Clerk of the Second Circuit*

JANUARY 17, 1945.

JOSEPH W. STEWART, ESQ.,
Clerk, U. S. Court of Appeals
for the District of Columbia,
Washington, D. C.

DEAR MR. STEWART: A question has arisen in a proceeding before the Supreme Court as to the precise time when judgment is considered to have been entered under the practice in one of the Circuit Courts of Appeals. For comparative purposes and for the information of the Court on argument, I would be pleased to receive from you a detailed statement as to the practice in your Court with respect to the entry of judgment orders. It would be helpful if this statement would cover the following questions:

1. Does the Court sign the opinion?
2. What entry is made to record the filing of the opinion?
3. Is any separate order entered that is labeled a judgment?
4. Is the Order for Mandate made pursuant to any express direction of the Court and is it entered in any bound record of the Court?
5. Is there any time requirement for 3 or 4 with relation to the date of the opinion, or in relation to each other?

6. Does the Court sign the order for Mandate or any other order after the filing of the opinion?

Your prompt reply will be greatly appreciated.

Yours sincerely,

CHARLES FAHY,
Solicitor General.

2. *Summary of the practice in the Court of Appeals for the District of Columbia and the Circuit Courts of Appeals, as taken from the reply of the Clerk of each court to the above letter:*

United States Court of Appeals for the District of Columbia

Upon the filing of an opinion, the Clerk prepares a separate judgment order which is signed by the judge who wrote the opinion and is entered on the docket and journal on the date of the filing of the opinion, as required by Rule 25 of the rules of the court. It is not the practice to enter an order for mandate, since Rule 27 providing for issuance of mandates is self-executing.

Circuit Court of Appeals for the First Circuit

A formal judgment is entered in each case on the date the opinion is delivered, as provided in Rule 31, paragraph 3, of the rules of the court. The judgment is signed by the Clerk of the Court but is examined and initialed by the Senior Circuit Judge. Mandates are issued as of course under Rule 35, paragraph 1, and it is not the usual practice to enter orders for mandates.

Circuit Court of Appeals for the Third Circuit

Upon filing of an opinion a separate judgment order is prepared by the Clerk and signed by one of the judges who sat in the case. This judgment is ordinarily filed as of the same date as the opinion. The mandate issues as a matter of course under the rules without an order as provided in Rule 38 of the court's rules, except that an order for mandate signed by the court is filed if the mandate is issued in advance of the time provided by the rule.

Circuit Court of Appeals for the Fourth Circuit

After the opinion in a case is filed, a separate order, labeled judgment, decree, or order, is signed by the judge who prepared the opinion, or if the judges are not in session it is signed by all judges who sat in the case. The judgment is usually, although not always, filed and entered on the date on which the opinion is filed, and is recorded in full on the minutes of the court. It is considered that judgment is entered on the date of the filing of the judgment in the Clerk's office. Under Rule 22 of the court's rules mandates issue as of course, and in the absence of rehearing, certiorari, or other special circumstances, it is not the practice to enter orders for mandates.

Circuit Court of Appeals for the Fifth Circuit

On the date the opinion is filed, the judgment of the court, which is called the judgment in the case, is drawn up in accordance with the opinion and is entered on the minutes. Mandates are

issued as provided in Rule 32 of the court's rules without entry of an order for mandate.

Circuit Court of Appeals for the Sixth Circuit

A separate order, labeled a judgment, is signed by the judge who wrote the opinion and is entered on the docket on the same date as the date of the opinion. No orders for mandates are made but the mandate is issued at the time provided by Rule 30 of the court's rules.

Circuit Court of Appeals for the Seventh Circuit

A separate order labeled a judgment is entered in the journal on the same date as that on which the opinion is filed (pursuant to Rule 20 of the court's rules), except in N. L. R. B. and F. T. C. cases in which formal decrees are entered (pursuant to Rule 34 (9)). No order for mandate is entered, but the mandate issues under Rule 25 without an order.

Circuit Court of Appeals for the Eighth Circuit

When an opinion has been filed with the Clerk, he enters a separate judgment or decree as required by the opinion, without submitting the form of the judgment to the court. Such judgment is usually entered at the time of filing the opinion and Rule 14 (b) of the court's rules provides that when the judgment is entered in conformity with the opinion it is the judgment and decree of the court. Mandates are issued by the Clerk as provided in Rule 16 without express direction by the court.

Circuit Court of Appeals for the Ninth Circuit

Upon the filing of an opinion a formal judgment is entered in accordance with the opinion in the minutes of the court, and is filed with the papers in the case. (Note that Rule 3, subdivision 5, of the rules of the court provides: "Appeals shall be deemed decided when announced from the bench in a session of the court at the place of the term in which they are submitted, or when the signed opinions or other documents evidencing their decision are filed with the clerk.") The mandate issues as of course without order agreeably to the provisions of Rule 28.

Circuit Court of Appeals for the Tenth Circuit

As soon as an opinion is filed and entered in the docket book, the Clerk draws up the judgment or decree directed by the opinion and copies it in the permanent record of the orders and judgments of the court. Rule 27 (3) of the court's rules provides that such judgment or decree, when so entered in conformity with the opinion, shall be the judgment and decree of the court. The judgment is always entered on the same day the opinion is filed, unless otherwise directed by the court. (Special decrees which are signed by the court are made in cases involving enforcement of decrees or orders of administrative agencies, boards or commissions, pursuant to Rule 34 (9).) Mandates issue under Rule 28 as provided therein and no order is ordinarily made with respect to the issuance of the mandate.

U. S. GOVERNMENT PRINTING OFFICE: 1945

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 710.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, EXECUTOR.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

ERWIN N. GRISWOLD,
HOLT S. MCKINNEY,
Counsel for the Respondent.

THE COURT PRESS, N. Y. C.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 710.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE AND TRUST COMPANY, Executor.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

Opinions Below.

The opinion of the Tax Court (R. 61-67) is reported at 1 T. C. 478. The opinion of the Circuit Court of Appeals (R. 79-81) is reported at 144 F. (2d) 272.

Jurisdiction.

The date on which the judgment of the Circuit Court of Appeals was entered is discussed in Point I of the brief (*infra*, pp. 4-9). The petition for a writ of certiorari was filed on November 29, 1944. The jurisdiction of this Court is invoked by the petitioner under §240(a) of the Judicial Code, as amended by the Act of February 13, 1925. The respondent in the brief below suggests that the petition was not filed within the time prescribed by §8(a) of the Act of February 13, 1925.

Question Presented.

The statement of the question in the petition has certain connotations which are not actually involved in the case. A more accurate statement of the question presented is as follows:

Whether money received by the respondent from a corporation in which it owned stock, as a part of a tax-free recapitalization of the corporation, had "the effect of the distribution of a taxable dividend" within the meaning of §112(c)(2) of the Revenue Act of 1936.

Statutes Involved.

The statutes involved are set forth at pages 16-20 of the petition, and need not be repeated here.

Statement.

The facts in this case were all stipulated (R. 14-60). They may be summarized as follows:

Edward T. Bedford died on May 21, 1931. Included in his estate were 3,000 shares of 7% cumulative preferred stock of Abercrombie and Fitch Company (par value of $100 per share). The fair market value of these 3,000 shares on the date of the decedent's death was $210,000 (R. 14).

Because of business conditions prevailing in the following years, the Abercrombie and Fitch Company incurred losses with the result that its surplus account showed an accumulated deficit on January 31, 1936 of $399,771.87. Included in the charges against surplus were the amounts capitalized by three stock

dividends paid in 1920, 1928 and 1930, aggregating $844,100 (R. 16, 59-60).

Because of the existence of the deficit on the company's books its credit was affected, and it had been unable for over five years to pay any dividends on either its preferred or common stock (R. 21-22). Accordingly, a Plan of Recapitalization was proposed and submitted to the stockholders for their consideration and approval (R. 14-15, 25-26). The plan was adopted by the shareholders at a meeting held on December 8, 1936, and was accordingly put into effect (R. 14-15).

In accordance with the Plan of Recapitalization, the petitioner, as executor of the estate of Edward T. Bedford, received in January, 1937, in exchange for its 3,000 shares of 7% cumulative preferred stock ($100 par value), the following: 3,500 shares of new cumulative preferred stock of a par value of $75 per share and an annual dividend of $6 per share; 1,500 shares of the common stock of the company with a par value of $1 per share; and cash in the amount of $45,240. Thus the respondent gave up securities with an aggregate par value of $300,000, and received securities with an aggregate par value of $264,000.[1] The aggregate fair market value of the property and cash received on January 15, 1937, was $349,740 (R. 15).

For the taxable year ended January 31, 1937, the Abercrombie and Fitch Company had net earnings after taxes of $309,073.70 (R. 16).

[1] Prior to the recapitalization, the capitalization of Abercrombie and Fitch Co. was $2,000,000 in preferred stock, plus common stock with a stated value of $500,000. After the recapitalization, the capital consisted of $1,575,000 in preferred stock, and $100,000 in common, or an aggregate of $1,675,000 (R. 25).

I.

Was the petition filed on time?

We seriously question whether the petition in this case was filed on time. Under the statute (§8(a) of the Act of February 13, 1925, 43 Stat. 936, 940), the application must be filed "within three months after the entry of such judgment or decree." This requirement is jurisdictional. *Toledo Scale Co.* v. *Computing Scale Co.*, 261 U. S. 399, 417-418.

The petition was filed on November 29, 1944. This was within three months after August 29, 1944, on which date the Court below entered its "order for mandate" (R. 82). If this order for mandate was the judgment of the Court below within the meaning of the Act of February 13, 1925, then the petition was filed on time. If any prior action of the Court was its judgment, then the petition was not filed on time.[2]

We submit that the order for mandate was not the judgment of the Court below, but that it was, on the contrary, just what its title indicates, namely, the order for the issuance of the mandate. The issuance of the mandate has nothing to do with the judgment itself, except that it must be rested upon a previously entered judgment. Therefore, the "order for mandate" rather connotes that it is not the judgment, but that a judgment has been previously entered.

The opinion in this case was filed on August 8, 1944. We recognize, of course, that the opinion as such is not the judgment of the Court. Nevertheless, the opinion in this case, filed with the Clerk of the Court

[2] No petition for rehearing was filed, or other action taken which would suspend the running of the three-months' period.

below on August 8, 1944, concludes with the following entry: "The order of the Tax Court is reversed" (R. 81). It should be noted that the statement is that the order *is* reversed, not that it will be or should be, nor that counsel should submit an order in conformity with the opinion. The statement purports to be a final act: the order is reversed.

On the same date, the Clerk made an entry in his records reading as follows:[3]

> "Aug. 8, 1944. Order reversed. A. N. Hand, *C. J.*"

This appears to be a definite statement in the record that the order is reversed on August 8, 1944. The significance of this entry stands out when the entries for August 29th are examined. These read as follows:

> "Aug. 29, 1944. Filed order for mandate.
> Aug. 29, 1944. Issued mandate."

These entries show the filing of an order[4] for mandate on August 29th, and the issuance of the mandate on the same day. But neither the order for the mandate, nor the actual issuance of the mandate would seem to be the judgment. The judgment is the definitive act of the Court, and that would seem to be recorded by the entry for August 8, 1944. Indeed, that is the only entry in the docket which connotes a judgment.

It is true that the order for mandate contains lan-

[3] See the Certificate by the Clerk of the Circuit Court of Appeals, which is printed in the Appendix. The original has been filed with the Clerk of this Court.

[4] Cf. the practice of this Court under which it occasionally orders that the mandate "shall issue forthwith". It is clear that such an order is not itself the judgment of this Court, but follows upon the previous entry of a judgment.

guage which reads like that often used for the entry of a judgment. But that is not important if the judgment was actually rendered at an earlier date. That the earlier order is in fact the judgment becomes clearer when the circumstances surrounding the order for mandate are considered. It is simply a loose sheet of paper kept in a filing cabinet along with the other papers, including correspondence, relating to the case. It is not entered in any bound record of the Court. It is not entered pursuant to any express direction of the Court, but is entered by the Clerk himself at what he considers to be a convenient time. In fact here the order for mandate was simply the ministerial act of a deputy clerk. The action of the Court is embodied in the sentence at the end of its opinion, and this was duly recorded by the Clerk on August 8, 1944. It is hard to escape the conclusion that that action was the judgment.

This conclusion finds support in the rules of the Circuit Court of Appeals in effect at the time these transactions occurred. Rule 30 of the Rules of the Circuit Court of Appeals for the Second Circuit, contains the following provisions:

> Rule 30. Taxing Costs—Order—Mandate.
>
> 1. Upon the filing of any decision by this court the clerk shall forthwith, or at any later time, if the court thinks justice requires it, enter the proper order * * *
>
> 2. A mandate may issue at any time on order of this court, but unless otherwise ordered shall issue at the expiration of fifteen days from the filing of the opinion of this court in the clerk's office unless delayed by the filing of the petition for rehearing.

> 3. If application for certiorari from the Supreme Court be made, application to stay the mandate shall be made only to this court, except in vacation when such application may be made to any judge of this court. * * *

The first paragraph of the rule goes a long way to show that the entry which the Clerk did make "forthwith" on August 8, 1944, was "the proper order", and, thus, the judgment. It is true that this rule provides that the order may be entered "at any later time, if the court thinks justice requires it". But the Court below took no action in this case to indicate that it thought that justice required any other action than that the Clerk should "forthwith" enter the order. Thus it appears that the order which the Clerk did enter "forthwith", taken in conjunction with the rule, is the order of the Court. This rule would seem to be similar in purpose and effect to the provision now included in Rule 58 of the Rules of Civil Procedure, last sentence.[5]

The contrast between "forthwith" in paragraph 1, relating to the "proper order", and "fifteen days" in paragraph 2, relating to the issuance of the mandate, is clear, and supports the conclusion, we submit, that the order which was in fact entered "forthwith" on August 8, 1944, was the judgment of the Court.

This is made even clearer when paragraph 3 of the rule is examined. This provides for a stay of the mandate where an application for certiorari is made. But an application for certiorari is filed to review a judgment, and if the order for mandate is itself the

[5] This reads as follows: "The notation of a judgment in the civil docket as provided by Rule 79(a) constitutes the entry of the judgment; and the judgment is not effective before such entry".

judgment; then there could be no stay of the mandate because the mandate would already have issued as a part of the judgment itself. This rule seems to make it very plain that the order for mandate is not the judgment. The mandate is something which issues, or is stayed, as the case may be, but *after* the judgment is entered. The entry which is the judgment, as provided in paragraph 1 of the rule, is that which is entered by the Clerk "forthwith" after the opinion is filed.

There may have been a carelessly accepted notion that the order for mandate constitutes the judgment in the Second Circuit. It is so stated in Robertson and Kirkham, Jurisdiction of the Supreme Court of the United States (1936) §384. But no authority is cited for the point. Such a notion, or even a common understanding, cannot change the statutes of the United States. And no reason is perceived why the order for mandate should be the judgment in the Second Circuit Court of Appeals, but not in other Circuit Courts of Appeals, nor in this Court. On the contrary, there is every reason why the practice in such a matter should be uniform in all the Federal courts.

It would seem that the situation is quite similar to that which this Court passed upon in *Department of Banking* v. *Pink*, 317 U. S. 264. It had, prior to that decision, been widely assumed that the time for filing a petition for certiorari following a judgment of the New York Court of Appeals began to run at the time of the subsequent entry of a judgment by the lower Court on the remittitur. The Court held that this practice was improper and that the three months' period began with the entry of the order by the

Court of Appeals. This decision is very closely applicable to the present situation. The decision in the *Pink* case was that there is no reason for a different period of review for decisions of the New York Court of Appeals from that applied in reviewing the decisions of other State courts. For similar reasons, there would seem to be no reason why the period for review of Circuit Courts of Appeals' decisions should be three months in nine of the ten circuits in the country, but three months and twenty-one days (or some other number of days as the Clerk or his deputy may chose) in the Second Circuit.

The decision in *United States* v. *Hark*, 320 U. S. 531, is not to the contrary. There the order which the Court treated as the judgment was the deliberate judicial act of the judge himself, and it is apparent (see especially 320 U. S. at 535) that this was an important factor in the decision. Here, the order for mandate was the merely ministerial act of a deputy clerk. The only act by the Court itself was that stated in the close of the Court's opinion: "The order of the Tax Court is reversed." And this was duly recorded by the Clerk in his formal records on August 8, 1944. It seems hard to escape the conclusion that this was the judgment (the basis for a claim of *res judicata*, for example), and not some subsequent act done by a deputy clerk of the Court on his own motion.

This Court has recently decided that "it is the petitioner's burden to show affirmatively that we have jurisdiction". *Gorman* v. *Washington University*, 316 U. S. 98, 101. We submit that that burden has not been met in this case.

II.

In any event the petition should be denied.

The petition cites thirty-seven cases, and claims conflicts with many of them. It is obviously impossible to analyze each of these cases in the space properly to be devoted to the present brief. It is clear, however, that all of the claimed conflicts are argumentative. There is no such direct conflict as is the usual basis for the exercise of this Court's discretionary power of granting certiorari. On the contrary, it appears that the Government's complaint is that it has lost a case in the Court below and that it would like to have this Court grant it a further hearing with a re-examination of all the various cases in the field.

The Government's difficulty is that it has failed to keep its attention focused on the precise question actually raised by the facts of this case. By making that question much broader than it actually is, the Government raises conflicts in several directions. But when the narrow question actually involved is isolated and examined, it is plain that there is no conflict with any decision.

For example, there was no question in the Court below of capitalizing earnings, or of the other matters which are covered by the first specification of error and the first reason for granting the writ. It was not suggested to the Court below that Abercrombie and Fitch Company did not have earnings and profits available. That was not the issue there, and the opinion of the Court must be read in the light of the issues which were submitted to it.

The sole question before the Court below was whether the payment in question came within §112(c)(1) or within §112(c)(2) of the Revenue Act of 1936.[6] It has been expressly conceded by both sides throughout this case that the transaction in question *was* a recapitalization, and thus a reorganization. Its taxability is, therefore, governed by one or the other of the two paragraphs of §112(c), and by no other provision of the Code. It is governed by §112(c)(1), and the gain is taxable as a capital gain, unless §112(c)(2) applies. The latter paragraph does apply only if the payment "has the effect of the distribution of a taxable dividend." What the Court below did, was to construe those words in the light of the actual facts of this case. Decisions in other cases, involving other statutory provisions, and different facts, cannot be in conflict with this decision.

The important fact in the present case, which was not present, or was not relied on, in any of the other cases, is that in the present case the capitalization of the company was reduced by the transaction. The Government has consistently failed to appreciate this point, and its failure to appreciate it is apparent throughout the petition and its misconception of the decision below.

It was not argued in the Court below that the transaction was a partial liquidation. As pointed out, there never was any dispute as to what the transaction *was*. It *was* a recapitalization. The Court below understood this. Under the statute, however, it became necessary to determine the "effect" of the payment. Was its "effect" like that of an ordinary dividend, or was its "effect" like something else? What the Court below has decided is that in view of

[6] These are set out in full at pages 16-17 of the petition.

the actual facts of the case—the reduction in capital by the corporation, and the inability to pay dividends under State law—the "effect" of the transaction was not that of an ordinary dividend but was more nearly like that of a partial liquidation, which, whatever it may be, is not an ordinary dividend, and thus not enough to bring §112(c)(2) into operation. It is clear that there is no conflict on this point.[7] It is likewise clear, in the context of the issue and argument actually submitted to the Court below, that the Court did not decide that the transaction *was* a partial liquidation, but rather that the transaction was in "effect" more like a partial liquidation than it was like an ordinary dividend.

[7] For example, five cases are claimed as conflicts on page 9 of the petition. This is sweeping with far too broad a brush. One of these cases, *Commissioner* v. *Forhan Realty Corp.*, 75 F. (2d) 268 (C. C. A. 2d), was decided by the Court below. In it there was no issue as to the general applicability of §112(c)(2). Its general applicability was conceded, but *the Commissioner* argued that it was not applicable in the particular case since the recipient of the payment was a corporation which was not taxable on dividends received. The same question was involved in *Rose* v. *Little Investment Co.*, 86 F. (2d) 50 (C. C. A. 5th); and the issue in *Commissioner* v. *Owens*, 59 F. (2d) 597 (C. C. A. 5th), was similar. In *Love* v. *Commissioner*, 113 F. (2d) 236 (C. C. A. 3d), the reorganization was by sale of assets, and not by recapitalization. In *Campbell* v. *United States*, 144 F. (2d) 177 (C. C. A. 3d), the question was one of the earnings and profits of the successor corporation, and of the applicability of the rule of *Commissioner* v. *Sansome*, 60 F. (2d) 931 (C. C. A. 2d), certiorari denied, 287 U. S. 667, to the particular situation before the Court. There is clearly no such question here.

No one of these cases involved a situation like the present case where there was a recapitalization of a continuing corporation whose outstanding capital was reduced as a part of the transaction. The fact that a payment of cash *without* a reduction of capital may have the effect of the distribution of a taxable dividend does not require the same result where the payment *is* made in connection with a reduction of the capital of the corporation. What the Court below decided was that the latter sort of transaction was more like a partial liquidation than an ordinary dividend, and no Court has ever decided otherwise.

The soundness of this conclusion is supported by the whole background and purpose of the non-recognition provisions of §112. What is it that is not recognized under §112? Under §112(b)(3), what is not recognized is *gain or loss* on an *exchange* of stock or securities in connection with a reorganization. The basic transaction is an *exchange*. This is a typical capital transaction. It is just what happened here. The present taxpayer gave up securities, and received in exchange therefor other securities and cash. Thus, if there were no special statutes affecting the situation, there would clearly have been a *capital gain* on an *exchange*. See *Cullinan* v. *Walker*, 262 U. S. 134; *Marr* v. *United States*, 268 U. S. 536. But Congress has intervened in this situation and provided that no gain or loss shall be recognized on such an exchange in connection with a reorganization (§112(b)(3)), with the further qualification that if cash is received on the exchange, then the gain shall be recognized, but only to the amount of the cash received. Section 112(c)(1). But the gain so recognized still remains *capital gain* realized on an *exchange*! This is the basic, normal situation. Section 112(c)(2) then provides that if the cash received had "the effect of the distribution of a taxable dividend" it shall be taxed as a dividend. But it by no means follows, as the Government has argued, that all cash received in connection with a reorganization has the effect of a dividend. It depends upon the circumstances, and here the significant circumstance is that the payment was made in connection with a reduction of the corporation's capital, and thus has more the "effect" of a partial liquidation than of anything else.

Let us consider, for example, the case of a shareholder who had a *loss* on such an exchange as that involved here; that is, one whose cost basis was higher than the amount of securities and cash which he received in the exchange. Would the Government contend in such a case that the cash was nevertheless taxable as a dividend if the corporation had earnings and profits? This seems very unlikely, in the absence of special facts not present here. Yet, to argue that it is a dividend in the present case, means that some stockholders would receive a dividend and some would not, on the very same transaction, depending not on what was done, but on what their cost basis happened to be. The Court below was sound in avoiding such a construction of §112(c)(2).

Similarly, suppose that stock is called and redeemed. The gain in such a case is a capital gain. The present transaction is not essentially different from that. The Court below was correct in construing §112(c)(2) as not requiring a different result. At any rate, there is clearly no case in conflict with its decision on similar facts.

What the Government is apparently seeking is a decision that all liquidating distributions are taxable as ordinary dividends to the extent that the corporation has earnings and profits. See the reference to *Woodard* v. *Commissioner*, 30 B. T. A. 1216, on page 12 of the petition. That is obviously a large question, which should not be considered by this Court until it is squarely raised by a case actually involving that question, and in a situation where this Court has the benefit of full consideration of that point by the two tribunals below. It should not be passed upon in a case involving the narrow ques-

tion of the construction of § 112(c)(2) as applied to specific facts which are not the same as those which have been involved in any other case.

CONCLUSION.

It is doubtful whether this Court has jurisdiction of the petition. In any event, the petition presents no conflict and no issue of general importance, and should accordingly be denied.

Respectfully submitted,

ERWIN N. GRISWOLD,
HOLT S. MCKINNEY,
Counsel for the Respondent.

December, 1944.

APPENDIX.

Certificate of Clerk of Circuit Court of Appeals.

UNITED STATES CIRCUIT COURT OF APPEALS

SECOND CIRCUIT

ESTATE OF EDWARD T. BEDFORD, TITLE GUARANTEE & TRUST COMPANY, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

I, ALEXANDER M. BELL, Clerk of the United States Circuit Court of Appeals, for the Second Circuit, do hereby certify that the docket entries in the above entitled case in this Court are as follows:

August	19, 1943	Filed record
August	31, 1943	Filed order extending time
October	7, 1943	Filed 24 copies, record
October	7, 1943	Filed brief, petitioner
October	22, 1943	Filed appearance, Commr by J. P. Wenchel, et al.
December	15, 1943	Filed appearance, Commr by S. O. Clark, Jr., et al.
December	15, 1943	Filed brief, respondent
January	3, 1944	Filed brief, petitioner, reply

August	8, 1944	Order reversed, A. N. Hand, *C. J.*
August	29, 1944	Filed order for mandate
August	29, 1944	Issued mandate
October	13, 1944	Certified record to Sol. Gen'l.
December	2, 1944	Filed notice.

Dated New York, December 8, 1944.

ALEXANDER M. BELL,
Clerk, United States Circuit Court
of Appeals.

[SEAL.]

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 710

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ESTATE OF EDWARD T. BEDFORD
Title Guarantee and Trust Company, Executor,
Respondent.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

ERWIN N. GRISWOLD,
HOLT S. McKINNEY,
Counsel for Respondent.

THE COURT PRESS, N. Y. C.

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ESTATE OF EDWARD T. BEDFORD
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Respondent.

BRIEF FOR THE RESPONDENT

Opinions Below

The opinion of the Tax Court (R. 38-42) is reported in 1 T.C. 478. The opinion of the Circuit Court of Appeals (R. 48-51) is reported in 144 F.(2d) 272.

Jurisdiction

The date on which the judgment of the Circuit Court of Appeals was entered is discussed in Point I of the brief (*infra*, pp. 8-24). The petition for a writ of certiorari was filed on November 29, 1944. (R. 52.) The jurisdiction of this Court is invoked by the petitioner under § 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented

1. Whether the petition for a writ of certiorari was filed within three months after entry of the judgment of the Circuit Court of Appeals as required by Section 8 of the Act of February 13, 1925, c. 229, 43 Stat. 940.

2. Whether money received by the respondent from a corporation in which it owned stock, as a part of a tax free recapitalization of the corporation, had "the effect of the distribution of a taxable dividend" within the meaning of § 112(c)(2) of the Revenue Act of 1936.

Statutes Involved

The statutes involved are set forth at pages 63-68 of the Government's brief, and need not be repeated here.

Statement

The facts in this case were all stipulated (R. 8-37). They may be summarized as follows:

Edward T. Bedford died on May 21, 1931. Included in his estate were 3,000 shares of 7% cumulative preferred stock of Abercrombie and Fitch Company (par value of $100 per share). The fair market value of these 3,000 shares on the date of the decedent's death was $210,000 (R. 8).

Because of business conditions prevailing in the following years, the Abercrombie and Fitch Company incurred losses with the result that its surplus account showed an accumulated deficit on January 31, 1936 of $399,771.87. Included in the charges against surplus were the amounts capitalized by three stock dividends paid in 1920, 1928 and 1930, aggregating $844,100 (R. 8, 37).

Because of the existence of the deficit on the company's books its credit was affected, and it had been unable for

over five years to pay any dividends on either its preferred or common stock (R. 11-12). Accordingly, a Plan of Recapitalization was proposed and submitted to the stockholders for their consideration and approval (R. 8-9, 14-15). The plan was adopted by the shareholders at a meeting held on December 8, 1936, and was accordingly put into effect (R. 8-9).

In accordance with the Plan of Recapitalization, the petitioner, as executor of the estate of Edward T. Bedford, received in January, 1937, in exchange for its 3,000 shares of 7% cumulative preferred stock ($100 par value), the following: 3,500 shares of new cumulative preferred stock of a par value of $75 per share and an annual dividend of $6 per share; 1,500 shares of the common stock of the company with a par value of $1 per share; and cash in the amount of $45,240. Thus the respondent gave up securities with an aggregate par value of $300,000, and received securities with an aggregate par value of $264,000.[1] The aggregate fair market value of the property and cash received on January 15, 1937, was $349,740 (R. 9).

For the taxable year ended January 31, 1937, the Abercrombie and Fitch Company had net earnings after taxes of $309,073.70 (R. 9).

The Tax Court, focusing its attention on the question of earnings and profits, held that there were earnings and profits, and concluded without more that the cash received was taxable as a dividend. The Circuit Court of Appeals held that the transaction was in effect a partial liquidation and thus that it did not have "the effect of the distribution of a taxable dividend" within the proper construction of § 112(c)(2) of the Revenue Act of 1936. Accordingly, it reversed the judgment of the Tax Court.

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1. Prior to the recapitalization, the capitalization of Abercrombie and Fitch Co. was $2,000,000 in preferred stock, plus common stock with a stated value of $500,000. After the recapitalization, the capital consisted of $1,575,000 in preferred stock, and $100,000 in common, or an aggregate of $1,675,000 (R. 14).

Summary of Argument

I

The petition was not filed within three months after the entry of the judgment of the court below as required by § 8(a) of the Act of February 13, 1925. The Government relies on the "Order for Mandate" which was filled out and signed by a deputy clerk of the court below on August 29, 1944 (R. 51-52). We submit, however, that the judgment of the court was duly entered prior to that date.

The judgment of the court was rendered on August 8, 1944. That is the date its decision was filed. That is the only date upon which any act was done by the court below itself.

The judgment so rendered was entered by the clerk on August 8, 1944. He not only filed the opinion on that date, but he also made an entry in the records of the court which reads as follows:

> August 8, 1944. Order Reversed, A. N. Hand, *C.J.*

It seems clear that this is an "entry," and that it is in fact the "entry" of the judgment which had been rendered by the court. The judgment is the definitive act of the court, and that is duly recorded by the entry for August 8, 1944. Indeed, that is the only entry in the docket which connotes a judgment.

This conclusion finds support in the rules of the court below. Rule 30 provides that when "any decision" of the court is filed with the clerk, he shall "forthwith . . . enter the proper order." In the light of this rule, it appears that the order which the clerk did in fact enter "forthwith" is the entry of the action taken by the court, and thus the entry of its judgment. The same conclusion is supported by Rule 27 of the court below which states in terms that a petition for rehearing is filed with respect to a "judgment" reached by the court.

No subsequent judgment was rendered by the court, and therefore no such judgment could be entered. In all of the cases relied upon by the Government, the subsequent judgment was rendered by the judges of the court themselves. In the present case, there was no action by the judges of the court after August 8, 1944. The filling in of the order for mandate was the act of the deputy clerk alone.

The correspondence between counsel and the clerk of the court below, printed in Appendix B (pp. 71-83) of the Government's brief, when examined in its entirety, supports the conclusion for which we contend. Although the clerk made certain sweeping statements in his letter to the Solicitor General, he failed to respond to specific questions with respect to these statements. Moreover, the clerk states that the entry which he made on August 8, 1944, was made "to indicate when this court decided the case, what this court did to the lower court's judgment and who wrote the opinion." We submit that the clerk's own words show that his entry on August 8, 1944, was in law the entry of the judgment of the court.

The contention that the judgment was entered prior to August 29, 1944, is supported by the decisions. In *Medhurst* v. *S. S. "South America,"* 264 U.S. 587, it was held that the controlling date was the date on which the court below acted, and not the date on which the clerk filed the order for mandate.

This Court has recently decided several cases involving related questions. In *Department of Banking* v. *Pink*, 317 U.S. 264, it refused to accept what theretofore had been a long prevailing practice with respect to the time for filing a petition for certiorari following a judgment of the New York Court of Appeals. The decision in *Cole* v. *Violette*, 319 U.S. 581, is similar in effect to that reached in the *Pink* case. In these cases, and in *Matton Steamboat Co.* v. *Murphy*, 319 U.S. 412, this Court has

shown its intention to clarify and standardize the events defining the three months period, and to confine it to a uniform period of three months from the time when the court below has acted.

II

The reorganization of the Abercrombie and Fitch Company did not have "the effect of the distribution of a taxable dividend" within the proper construction of § 112(c)(2) of the Revenue Act of 1936. The parties are in agreement that the transaction was a recapitalization, and thus a "reorganization" as defined in § 112(g) of the Revenue Act of 1936. The sole question in the case is whether the amount of cash received on the exchange is taxable as a capital gain under § 112(c)(1) or is taxable in full as an ordinary dividend, under § 112(c)(2).

No question is raised as to the existence of earnings and profits in the corporation at the time of recapitalization. The Government's argument is in substance that wherever a corporation has earnings and profits a payment of cash in connection with a reorganization necessarily, and regardless of the circumstances, "has the effect of the distribution of a taxable dividend" within the meaning of § 112(c)(2). We believe that the Government claims too much from the statute.

The Government's construction (a) gives no effect to the controlling words which Congress wrote into § 112(c)(2); and (b) leaves no room within which § 112(c)(1) has any effective operation. Both provisions of the section can be given full and harmonious operation if proper weight is given to the "effect" clause in § 112(c)(2).

A helpful analogy in the construction of § 112(c)(2) is found in the provisions of § 115(g). The court below was correct in referring to decisions under § 115(g).

The "effect" of the transaction was that of a partial liquidation. The capital of the corporation was reduced by the transaction, and the reduction of the capital was the basic reason for carrying it out. That a liquidating distribution is not an ordinary taxable dividend was held in the leading case of *Hellmich* v. *Hellman*, 276 U.S. 233. Another case bearing closely on the present point is *Foster* v. *United States*, 303 U.S. 118. See also *Helvering* v. *Credit Alliance Co.*, 316 U.S. 107, 110, where this Court stated that "a distribution in liquidation of earnings . . . does not constitute a dividend in the proper sense of the term."

The substance of the transaction falls within the definition of a partial liquidation in § 115(i) of the statute.

None of the many cases cited by the Government on the construction of § 112(c)(2) involved a situation where the capital of the corporation was reduced as a part of the transaction. The failure to recognize the fact that the cash paid here was paid in connection with the reduction of the corporation's capital runs through the Commissioner's whole brief. The "effect" of a cash payment in connection with a reorganization depends upon the nature and circumstances of the particular reorganization. Here there was no selling out with an accompanying distribution of surplus. Instead, there was a reduction of the corporation's capital. A payment made in connection with such a transaction "has the effect of" a partial liquidation rather than the distribution of an ordinary dividend, and thus is not within the language or the purpose of § 112(c)(2).

The Committee Reports and the regulations show the inapplicability of § 112(c)(2). They show that § 112(c)(2) was designed to reach a different sort of transaction than that involved here, and particularly that it was not intended to apply to transactions which have the effect of liquidating dividends rather than of ordinary taxable dividends.

The Government's position leads to incongruities. These difficulties disappear if it is recognized that a distribution in connection with a reorganization which has the "effect" of a partial liquidation is not with the scope of § 112(c)(2).

Argument

I

The Petition Was Not Filed in Time

In its brief in opposition, the taxpayer questioned whether the Government's petition had been filed "within three months after the entry of such judgment or decree," as required by § 8(a) of the Act of February 13, 1925, 43 Stat. 936, 940. In its order granting certiorari, this Court requested counsel to discuss the question "whether the application for certiorari was filed within the time provided by law." (R. 52.)

The petition was filed on November 29, 1944. (R. 52.) This was within three months after August 29, 1944, which is the date on which a deputy clerk of the court below filled out and signed an "Order for Mandate." (R. 51-52.) If the filling in of this order for mandate was the entry of the judgment of the court below within the meaning of the Act of February 13, 1925, then the petition was filed on time. If any prior action constituted the entry of the judgment, then the petition was too late.[2]

We submit that the judgment of the court below was entered prior to the filing of its "Order for Mandate," and that that order was in fact what its title indicates, namely, the order for the issuance of the mandate. The title "Order for Mandate" connotes that it is not the judgment, but that a judgment has been previously entered.

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2. No petition for rehearing was filed, or other action taken which would suspend the running of the three-months' period.

A. The Judgment of the Court was Rendered on August 8, 1944

The opinion in this case was filed on August 8, 1944. It expressly appears in the heading of the opinion that the case was "Decided August 8, 1944." (R. 48.) "Decided" would seem to mean that what was done was a decision. This Court has declared that "The court's decision of a case is its judgment thereon." *Rogers* v. *Hill*, 289 U.S. 582, 587. We recognize, of course, that the opinion as such is not the judgment of the court. As this Court said in *Rogers* v. *Hill, supra*, "Its opinion is a statement of the reasons on which the judgment rests." But the same document may embody both the opinion, or reasons, and the decision, or judgment. Certainly the document which was filed on August 8, 1944, purports to dispose of the case finally and completely. It was not a tentative opinion to which counsel were invited to file exceptions. It is headed with the word "Decided," and it concludes with the clear and definitive statement: "The order of the Tax Court is reversed." (R. 51.) Indeed, this was the *only* act which was done by the court below itself. The judgment is the act of the court. It is a judicial act. The judgment can only be rendered by a judge. Thus it would seem clear that the decision filed on August 8, 1944, was the actual rendition of the judgment of the court. See 1 Freeman, Judgments (5th ed. 1925) § 46.

B. The Judgment so Rendered was Entered On August 8, 1944

But it may be that the important item under the Act of February 13, 1925, is not the judgment, but the entry of the judgment. We must therefore look to see when the judgment of the court so rendered was "entered." On examination, we find two items either one of which would seem to constitute the "entry" of the judgment made by

the court. First, we refer to Rule 26 of the rules of the court below, the first paragraph of which reads as follows:

> Rule 26. Opinions of the Court.
>
> 1. All opinions delivered by the court shall, immediately upon the delivery thereof, be handed to the clerk to be recorded.

Under this rule, therefore, when the opinion was handed to the clerk on August 8, 1944, it was "immediately" recorded by the clerk. This would seem to be sufficient of itself to constitute the "entry" of the judgment or decision of the court. But we need not rely upon this alone. The clerk on the same date, August 8, 1944, also made an entry in the records of the court which reads as follows:[3]

> August 8, 1944. Order reversed, A.N. Hand, *C.J.*

This is clearly an "entry," and it seems equally clear that it is in fact the "entry" of the judgment which had been rendered by the court. Let us assume that the clerk took no further action after August 8, 1944, and that a petition for certiorari was filed within three months after that date. It does not seem possible that this Court would dismiss such a petition on the ground that it was prematurely filed. If this is sound, it follows that what was done on August 8th was the entry of a judgment.

The significance of this entry stands out when the entries for August 29th are examined. These read as follows:

> August 29, 1944. Filed order for mandate.
> August 29, 1944. Issued mandate.

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3. See the certificate by the clerk of the Circuit Court of Appeals printed in the appendix to this brief (*infra*, p. 43). The original has been filed with the Clerk of this Court.

These entries show the filing of an order for mandate on August 29th, and the issuance of the mandate on the same day. But neither the order for the issuance of the mandate, nor the actual issuance of the mandate would seem to be the judgment, as this Court's own practice clearly shows. The judgment is the definitive act of the court, and that is duly recorded by the entry for August 8, 1944.[4] Indeed, that is the only entry in the docket which connotes a judgment.

It is true that the order for mandate is entered up on a printed form which contains language reading like that often used for the entry of a judgment. But that is not important if the judgment was actually entered at an earlier date. Here, the order for mandate was simply the ministerial act of a deputy clerk, for the deputy clerk obviously has no judicial power. The only action by the court itself is that embodied in the heading and in the sentence at the end of its opinion; and the result so reached was duly "entered" by the clerk on August 8, 1944.

The Government's brief almost completely ignores this entry of August 8, 1944, and its importance in this case. The Government seeks to confine the taxpayer to the argument "that the concluding sentence of the opinion constitutes the court's judgment." (Br. 11.) The taxpayer

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4. Reference may be made to a decision of the court below, which, though directly involving practice in the district courts, is important, we believe, in showing the practice in the circuit. This case is *The Washington*, 16 F.(2d) 206 (C.C.A. 2d). The question was when a decree had been entered by the clerk of the district court. There had been delay due to the actions of the clerk. The court noted (16 F.(2d) at 207) that this was not the act of the judge. It held that the decree must be regarded as "filed" and "entered" at the time the judge acted, although the clerk did not then make an entry "in the book commonly known as the 'docket,' or 'admiralty docket.'" 16 F.(2d) at 207. But in the present case the clerk did make an entry in his docket on August 8, 1944, showing precisely what "this court did to the lower court's judgment." Clerk's letter of January 23, 1945; Government's Br. 75. The decision in *The Washington* shows that that is what the court below regards as the normal way in which a judgment is entered.

makes that argument; but it also argues that what the clerk did on August 8, 1944, constituted the "entry" of that judgment. This is evaded throughout the Government's brief. The bare fact is stated at the opening of the Government's argument (Br. 9); it is never mentioned or discussed again.

That the entry which the clerk in fact made on August 8, 1944, was the entry of the judgment finds further support in the rules of the court below. Rule 30 of its rules contains the following provisions:

> Rule 30. Taxing Costs — Order — Mandate.
>
> 1. Upon the filing of any decision by this court the clerk shall forthwith, or at any later time, if the court thinks justice requires it, enter the proper order . . .
>
> 2. A mandate may issue at any time on order of this court, but unless otherwise ordered shall issue at the expiration of fifteen days from the filing of the opinion of this court in the clerk's office unless delayed by the filing of the petition for rehearing.
>
> 3. If application for certiorari from the Supreme Court be made, application to stay the mandate shall be made only to this court, except in vacation when such application may be made to any judge of this court. . . .

The first paragraph of this rule induces the conclusion that the entry the clerk made "forthwith" on August 8, 1944, was "the proper order," and therefore the entry of the judgment. It is true that this rule provides that the order may be entered "at any later time, if the court thinks justice requires it." But here the entry was not in fact made at a later time. The clerk made the entry "forthwith" on August 8, 1944, in direct compliance with the rule. The court in no way indicated that it thought that justice required any other action. Thus, in the light of Rule 30, it appears that the order which the clerk

did in fact enter "forthwith" is the "entry" of the action taken by the court, and thus the entry of its judgment. The purpose and effect of this rule is similar to the provision now included in Rule 58 of the Rules of Civil Procedure, last sentence.[5]

The contrast between "forthwith" in paragraph 1 of Rule 30, relating to the "proper order," and "fifteen days" in paragraph 2, relating to the issuance of the mandate, is clear, and supports the conclusion, we submit, that the order which was in fact entered "forthwith" on August 8, 1944, was the entry of the judgment of the court.

Paragraph 3 of the Rule, providing for a stay of the mandate where an application for certiorari is made, makes this even clearer. An application for certiorari is filed to review a duly entered judgment. If the order for mandate itself constitutes the "entry" of the judgment, there could be no stay of the mandate. The entry of the judgment itself would command the issuance of the mandate, since that is what an "order for mandate" is. If there is to be a stay of the mandate, there must be a judgment before the mandate issues. If the judgment itself is entered by the order for *issuing* the mandate, it seems difficult to see how the mandate could at the same time be *stayed*. It could perhaps be *recalled*; but that is not what the Rule provides for. Thus this paragraph of the Rule plainly contemplates that the judgment is not entered contemporaneously with the issuance of the mandate, which would be the situation if it were held that there is no judgment except as a part of the order for issuing the mandate.[6]

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5. This reads as follows: "The notation of a judgment in the civil docket as provided by Rule 79(a) constitutes the entry of the judgment; and the judgment is not effective before such entry."

6. The Government's brief says (Br. 13, n. 5) that this argument by the taxpayer "appears to confuse the order for mandate with the mandate itself." On the contrary, the difficulty would seem to be that the Government confuses the order for mandate with the judgment.

This conclusion is also supported by Rule 27 of the court below, which reads as follows:

> Rule 27. Rehearing.
>
> 1. A petition for re-hearing may be filed within fifteen days from the filing of the opinion of this court in the clerk's office. It must be printed, and briefly and distinctly state its grounds, and be supported by certificate of counsel; and will not be granted or permitted to be argued, unless a judge who concurred in the *judgment* desires it and a majority of the court so determines.
>
> 2. If a petition for re-hearing be filed within the time herein limited, no mandate shall issue pending the disposition of said petition. (Italics ours.)

Thus, the court below has stated its understanding that there is a "judgment" upon the filing of its opinion. The petition for rehearing is to be filed with respect to a "judgment," and it is to be filed within fifteen days. That cannot be done if there is no judgment during the fifteen-day period. Moreover, the second paragraph of the Rule provides that no mandate shall issue if a petition for rehearing is filed. From this it seems to follow that the "order for mandate," that is, the order directing the issuance of a mandate, cannot be the judgment of the court. If it were, there could be no rehearing from the "judgment," as provided in paragraph 1. Furthermore, the second paragraph of the Rule would not be necessary unless there were already a judgment when the petition for rehearing is filed, within the fifteen-day period.

C. No Subsequent Judgment was Rendered by the Court, and Thus No Such Judgment Could be Entered.

We turn next to the argument of the Government that even if there was a judgment on August 8, 1944, the "order for mandate," signed by the deputy clerk on August 29,

1944, constituted the entry of a new judgment, and that the period for certiorari began again to run from the latter date. We do not doubt that the court below has continuing power over its judgments during the term, or until the time for applying for certiorari has expired. Accordingly, the court below, by proper action of its judges could undoubtedly have vacated its judgment, or could have rendered a new judgment. If such a new judgment had been rendered by the judges, then the period for certiorari would very likely have begun to run from the date of the new judgment. But we do not believe that the deputy clerk of the court below has power, or can be given power, to render new judgments which will have the effect of superseding already existing judgments. The deputy clerk has no judicial power, and we submit that a new judgment can only be entered pursuant to judicial action.

All of the cases cited by the Government are clearly distinguishable on this ground. Thus, in *Rubber Co.* v. *Goodyear*, 6 Wall. 153, it expressly appears (p. 155) that the new judgment was signed "J. R. Bullock, District Judge." In *Silsby* v. *Foote*, 20 How. 290, it is stated (p. 295) that the second decree was "signed by the judge." In *United States* v. *Midstate Co.*, 306 U.S. 161, the record shows that the final order was signed "Welch, J." See R. 31, No. 286, October Term, 1938. Finally, in *United States* v. *Hark*, 320 U.S. 531, the second order was signed "George C. Sweeney, U. S. D. J." (320 U.S. at 533); it was the deliberate judicial act of the judge himself, and it is apparent (see especially 320 U.S. at 535) that this was an important factor in this Court's decision.[7]

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7. Similarly, in *United States* v. *Rayburn*, 91 F. (2d) 162 (C.C.A. 8th), it expressly appears (p. 164) that the second order was signed "Chas. A. Dewey, United States District Judge." The two other cases relied on by the Government (*Wright* v. *Gibson*, 128 F.(2d) 865 (C.C.A. 9th), and *Monarch Brewing Co.* v. *George J. Meyer Mfg. Co.*, 130 F.(2d) 582 (C.C.A. 9th)) are

[Footnote continued on following page.]

Ex parte Morgan, 114 U.S. 174, which the Government cites, is an authority that the clerk's act of recording a judgment is a "ministerial act." The case supports our contention that the only function of the clerk is to record the actions of the court, but that he "does not thereby render the judgments." 114 U.S. at 175.

In the present case, there was no action by the judges of the court after August 8, 1944. The filling in of the order for mandate was the act of the deputy clerk alone. It was not submitted to the court, nor signed or initialed by any of the judges of the court, nor approved by the court in any way. If we grant that the judges of the court could have rendered a new judgment, the fact is clear that they took no such action. We submit that the deputy clerk did not have power, and could not be given power, to *render* a new judgment. Therefore his action on August 29, 1944, could not start the period running again if it had already started to run from the entry made on August 8, 1944. As already pointed out, no case cited by the Government holds that an action by the clerk constitutes the rendition of a new judgment.

D. The Correspondence with the Clerk of the Court Below

Before examining further decisions bearing on the question, we will turn to a consideration of the correspondence between counsel for the parties and the clerk of the court below. At the suggestion of counsel for the taxpayer

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[Footnote continued from preceding page.]

decisions of the familiar proposition that an order which does no more than grant a motion is interlocutory, and not a final judgment.

The decision in *Puget Sound Co.* v. *King County*, 264 U.S. 22, turned upon the clear provision of the applicable Washington statute (Wash. Comp. Stat. (Remington 1922) § 11), which drew a distinction between the decision of the state court and its judgment. By the Washington law, only the later act was the judgment, and thus this alone was sufficient to start the review period.

that it might be convenient for the Court to have all of this correspondence printed in one place in chronological order, the Solicitor General has kindly set forth all of the letters in Appendix B (pp. 71-83) to his brief.

We respectfully request that the Court carefully consider all of these letters, noticing what the clerk did not state, as well as what he did. In his letter to the Solicitor General of January 23, 1945 (Government's Br. 74-78), the clerk made a number of sweeping statements, a good many of which are more in the nature of argument, or assertion of conclusions, than they are certificates of matter of fact. The clerk's arguments, of course, are entitled to no more weight than those made by counsel. In an effort to separate the clerk's arguments from his statements, counsel for the taxpayer submitted to the clerk certain specific questions. Letter of January 29, 1945; Government's Br. 78-80. The clerk's failure or inability to respond to these questions is, we submit, significant, and removes all support from much of his letter of January 23rd. We have no doubt that the clerk believes that the order for mandate which his deputy filled in on August 29, 1944, was the judgment of the court. But that is not for the clerk to decide. It is the issue here. If the entry actually made on August 8, 1944, was the entry of the judgment, then the later actions of the clerk's deputy are not enough to start the three months' period running again.

Certain portions of the clerk's letters do appear to us to be of considerable significance. We refer particularly to the fifth paragraph of his letter of January 23rd (printed at the bottom of p. 75 of the Government's brief). There, the clerk, referring to his entry of August 8, 1944 (which reads "Order reversed, A. N. Hand, *C.J.*"), says "The entry is made briefly to indicate when this court *decided the case, what this court did to the lower court's judgment* and who wrote the opinion." (Italics ours.) But the entry of when the court "decided" the case and what the court "did to the lower court's judgment" amounts

to the recording or entry of the court's judgment. We submit that the clerk's own words show that his entry on August 8, 1944, was in law the entry of the judgment of the court.

Reference should also be made to the clerk's two brief letters of January 31, 1945, and February 6, 1945 (Government's Br. 80, 83). In the first, the clerk indicates that his failure to issue the order for mandate fifteen days after the opinion was filed, as required by Rule 30, paragraph 2 of the rules of the court, was because he was waiting for the payment of costs. But it has long been settled that a judgment is final, and starts the running of the period for review, although costs are to be taxed later. *Fowler* v. *Hamill*, 139 U.S. 549. This rule is clearly recognized in the Second Circuit. *Prescott & A.C.Ry. Co.* v. *Atchison, T. & S. F. R. Co.*, 84 Fed. 213 (C.C.A. 2d); *Tuttle* v. *Claflin*, 66 Fed. 7, 8. (C.C.A. 2d); *Stallo* v. *Wagner*, 245 Fed. 636, 639-40 (C.C.A. 2d).[8]

In the second of these letters, that of February 6th (Government's Br. 83), the clerk gives as a reason for his position that the judgment is not entered until after the expiration of fifteen days, that "The fifteen-day period affords counsel for the losing party an opportunity to file a petition for rehearing." This shows, we submit, a misconception on the clerk's part as to the relation between the judgment and a petition for rehearing. It is not necessary to hold up the entry of the judgment in order to allow an opportunity for a petition for rehearing. All that is necessary to protect the losing party fully is to hold up the issuance of the mandate. That is provided for in Rule 27, paragraph 2 of the rules of the court below. The first paragraph of that rule and general practice show that the petition for rehearing is filed with respect to a judgment which has previously been entered.

8. To the same effect are *Allis-Chalmers Co.* v. *United States*, 162 Fed. 679 (C.C.A. 7th); *Crowell* v. *United States*, 281 Fed. 835 (D. Mass.); *United States* v. *Nordbye*, 75 F.(2d) 744, 746 (C.C.A. 8th); *Sosa* v. *Royal Bank of Canada*, 134 F.(2d) 955, 956 (C.C.A. 1st).

We submit, therefore, that the net effect of the exchange of correspondence is to support the taxpayer's position in this case.

E. The Decisions Support the Contention that the Judgment was Entered Prior to August 29, 1944.

The question of the date of entry of judgments in the Second Circuit has previously been a source of difficulty.

In *Medhurst* v. *S. S. "South American,"* 264 U.S. 587, the body of the order for mandate carried the date October 15, 1923. On the back, it was marked "Filed, October 16, 1923." The case was docketed in this Court on January 16, 1924, and the Court denied certiorari "for failure to file within the time prescribed by the statute." Examination of the record in this case, as filed with the Clerk of this Court, shows that the order for mandate was initialed "H.W.R." and "J.M.M." The case was heard before Rogers, Hough and Mayer, *JJ.*, and these are the initials of Judges Rogers and Mayer. Thus, in this case the order for mandate was the judicial action of the court. The case, therefore, is an authority in favor of the taxpayer's position here; for it decides that the important date is the date when the judges act (October 15, 1923), and not the date when the clerk does something (October 16, 1923, in that case). It would seem quite as clear in the present case as in the *Medhurst* case that the act of the clerk was purely ministerial, and neither could nor did extend the time for review.

Of course the *Medhurst* case is not a decision that the petition there would have been filed on time if it had been filed within three months after October 15, 1923. That question was not presented. Even if it had been decided there, it would not control here because there the order for mandate was the judicial act of the Judges, while here it was issued solely by the deputy clerk.

In *Cahill* v. *Mayflower Bus Line, Inc.*, 296 U.S. 629, the order for mandate was dated and filed on June 17, 1935. The petition was filed September 21, 1935. This was within three months from the date on which the judgment pursuant to the mandate was entered in the trial court. This Court denied the petition for failure to file on time.[9] This does not affect the present case, as it is not a decision that the petition would have been on time if it had been filed by September 17, 1935. The petitioner's action in that case, however, was in accordance with common New York practice (*cf. Department of Banking* v. *Pink*, 317 U.S. 264, discussed below), and the Court's action is therefore significant as showing that the specific requirements of the statute as to the time within which a petition must be filed are not affected by practices or understandings as to the time when the period begins to run.

Finally, reference may be made to *Helvering* v. *Lerner Stores Corp.*, certiorari granted, 314 U.S. 598, decided on the merits, 314 U.S. 463. Here the opinion was filed on March 24, 1941. The order for mandate was filed April 12, 1941. The petition was filed in this Court on July 8, 1941. The question whether the petition was filed on time was raised by the taxpayer in his brief in opposition. The taxpayer argued that the opinion was the judgment. He did not show, as we have done here, that the clerk actually made an "entry" in his records on the same date, showing the action of the court. Neither did the taxpayer rely on the terms of Rules 27 and 30 of the court below. This Court granted certiorari, and decided the case on the merits. It is clear, however, that it did not "decide" any question as to the jurisdiction, because the question was abandoned by the taxpayer in his brief on the merits. In that brief (p. 1), under "Jurisdiction," the taxpayer stated that the judgment below "was entered April 12, 1941 (R. 31)." The issue was not mentioned in either the tax-

9. The same result was also reached in a similar situation in *Warshauer* v. *Lloyd Sabaudo, S.A.*, 293 U.S. 610.

payer's or the Government's briefs. There is no reference to it in the opinion of this Court.

It is true that in the *Lerner Stores* case, and doubtless in other cases, this Court has rendered decisions in cases where it did not have jurisdiction, if our position is correct. That is, of course, no reason for deciding the present case without jurisdiction. In no previous case has the question actually been decided by the Court. "Questions which merely lurk in the record" (*Webster* v. *Fall*, 266 U.S. 507, 511) are not decided by the Court. Moreover, a decision in favor of the taxpayer on the jurisdictional question here would not affect the validity of any of those decisions. Under a now familiar line of cases, the question of jurisdiction in those cases is now *res judicata*, and beyond question by the parties. *Stoll* v. *Gottlieb*, 305 U.S. 165; *Chicot County Drainage District* v. *Baxter State Bank*, 308 U.S. 371; *Jackson* v. *Irving Trust Co.*, 311 U.S. 494.

This Court has recently decided several cases involving related questions. In *Department of Banking* v. *Pink*, 317 U.S. 264, it refused to accept what theretofor had been a long prevailing practice with respect to the time for filing a petition for certiorari following a judgment of the New York Court of Appeals. It would appear that the practice which was rejected there was strictly analogous to the practice upon which reliance was rested in this case. Under that practice, something done after the action of the court which decided the case had been regarded as the judgment for the purpose of starting the review period. The decision in the *Pink* case was that there was no reason for a different period of review for decisions of the New York Court of Appeals from that applied in reviewing the decisions of other State courts. For similar reasons, there would seem to be no reason for perpetuating a special period of review for decisions of the Second Circuit Court of Appeals. As shown by

the letters summarized in Appendix C (pp. 85-88) of the Government's brief, no other circuit has a practice like that which is followed by the Second Circuit.

If the "order for mandate" were in all cases filed fifteen days after the Court's decision is made, the matter might not be serious, although there is no particular reason for automatically adding fifteen days to the period prescribed for review. But, in the present case the delay was actually twenty-one days. In *International Standard Electric Corp.* v. *Commissioner*, Nos. 739-740, October Term, 1944, the period was twenty-nine days. Reference may also be made to two recent cases which have come to our attention. In *Katz* v. *Horni Signal Mfg. Corp.*, 145 F.(2d) 961 (C.C.A. 2d), a petition for rehearing was denied December 20, 1944. The order for mandate was filed February 9, 1945, an interval of 51 days. In *United States ex rel. Reed* v. *Badt*, 141 F.(2d) 845 (C.C.A. 2d), the court's decision was rendered on April 13, 1944. The order for mandate was filed June 13, 1944, two months later. It is also relevant to point out that in this case the order for mandate was filed 17 days *before* the clerk's fees were paid, which, according to his records, was on June 30, 1944. Thus the clerk's explanation (in his letter of January 31, 1945; Government's Br. 80), even if material, which we by no means concede, does not represent the consistent practice in the Second Circuit.[10] In all of these cases, as here, the clerk made an appropriate "entry" on the date on which the court actually rendered its decision.

These illustrations show that after a decision is reached by the Second Circuit Court of Appeals, the time for the review of that decision, if the practice on which the Gov-

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10. Indeed, the reference to the payment of fees merely aggravates the situation. If the entry of the judgment is to be held up until the clerk receives his fees, the prevailing party can postpone review indefinitely by simply failing to pay the fees. This would clearly be contrary to the intention of Congress in fixing the three months' limit on the review period.

ernment relies here is upheld, is extended for a length of time which varies from case to case, not by any action by the court itself, but solely by the clerk, or his deputy, in determining when he will fill out the order for mandate. This, we submit, is an unsound practice, inconsistent with the basic intention of Congress in prescribing the three months' limitation, and contrary to the terms of the rules of the court below. The clerk's argument on this point, near the end of his letter of January 23rd (Government's Br. 78), and the similar argument by the Government (Br. 20-21) amount to no more than a begging of the question. Of course, if the order for mandate is the judgment, then there is only a period of three months from that date. But if some prior action is in fact the entry of the judgment, then the three months' period is extended if it is made to run from the date of the order for mandate. To treat the latter order as the point at which the three months' period begins to run does, *in substance*, we submit, allow a different period for review of judgments for the Second Circuit from that applied in all other circuits, and is contrary to the underlying purpose of Congress in prescribing the three months' review period.

The decision in *Cole* v. *Violette*, 319 U.S. 581, is similar in effect to that reached in the *Pink* case. Again local practice was held not to be controlling. In *Matton Steamboat Co.* v. *Murphy*, 319 U.S. 412, this Court decided a somewhat related question contrary to the conclusion reached in Robertson and Kirkham, Jurisdiction of the Supreme Court of the United States, pp. 717-18. In reaching this result, the Court referred (319 U.S. at 415) to the uncertainties and delay which would result from a different conclusion. We submit that similar uncertainties and delays result from leaving the start of the three months' period to the time when the clerk or his deputy chooses to act. In all of these recent cases, *Pink*, *Cole* and *Matton*, this Court has shown its intention to clarify

and standardize the events defining the three months' period, and to confine it to a uniform period of three months from the time when the court below has acted. The application of these principles here leads to the conclusion that the petition in this case was not filed on time.

We submit that the judgment was entered on August 8, 1944, that no act by the court constituted the rendition of a new judgment thereafter, and that consequently the petition filed on November 29, 1945, was filed too late.

II

The reorganization of the Abercrombie and Fitch Company did not have "the effect of the distribution of a taxable dividend" within the proper construction of Section 112(c)(2) of the Revenue Act of 1936.

Throughout this proceeding, the parties have agreed that the exchange which the taxpayer made with Abercrombie and Fitch Co. in January, 1937, was in connection with a recapitalization, and thus was a "reorganization" as defined in § 112(g) of the Revenue Act of 1936. Since cash was received on the exchange, § 112(c) of the statute (Government's Br. 64) comes into operation. The sole question in the case is whether the amount of that cash is taxable as a capital gain under § 112(c)(1), or is taxable in full as an ordinary dividend under § 112(c)(2).

This question turns on the proper construction of the words "has the effect of the distribution of a taxable dividend" in § 112(c)(2). We submit that the cash payment here did not have "the effect of the distribution of a taxable dividend," and that § 112(c)(2) therefore has no application. If this argument is correct, then § 112(c)(1) does apply, and the gain should be taxed as a capital gain.

A. Earnings and Profits

The Government devotes nearly ten pages of its brief (Br. 23-32) to an argument that Abercrombie and Fitch Co. had earnings and profits at the time of the recapitalization in an amount at least equal to the amount of cash which it paid out. No contention to the contrary was made in the court below. This was expressly stated in our Brief in Opposition (p. 10), as the Government recognizes at the end of its discussion of the question (Br. 32). It is difficult to see, therefore, why the question should be argued at such length in the Government's brief. This unnecessary argument should not divert the Court's attention from the question which is involved in the case.

As already indicated, that question relates solely to the proper construction of § 112(c)(2) of the Revenue Act of 1936, which applies only to payments which have "the effect of the distribution of a taxable dividend." It was to this point only that the attention of the court below was directed. In this light, the citations in the court's opinion of *Commissioner* v. *Quackenbos*, 78 F.(2d) 156 (C.C.A. 2d), and *DeNobili Cigar Co.* v. *Commissioner*, 143 F.(2d) 436 (C.C.A. 2d), were not in any way nor to any extent a decision that the corporation here did not have earnings and profits. They were cited in support of the decision, and, we submit, the proper decision, that regardless of earnings and profits the payment here did not have "the effect of the distribution of a taxable dividend."

We turn then to the question of the construction of § 112(c)(2).

B. Section 112(c)(2) of the Revenue Act of 1936 Does Not Make All Cash Payments in Connection with a Reorganization Taxable as a Dividend Merely Because there are Earnings and Profits.

The Government's position is based on its contention (Br. 42-43) that § 112(c)(2)—

> applies to *any distribution* in a reorganization *if there are earnings and profits* to cover it, without any limitation as to the time and manner in which the distribution may have been made. (Italics ours.)

This argument runs through the Government's brief. It is also stated on page 35, again on page 40, on page 46, and elsewhere. We believe that the Government claims too much from the statute.

In the first place, let us look at what Congress actually said. In § 112(c)(2), Congress provided that—

> If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection *but has the effect of the distribution of a taxable dividend*, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. . . . (Italics ours.)

The Government simply excises from the statute the whole phrase which Congress wrote restricting this provision to situations where the payment "has the effect of the distribution of a taxable dividend." The Government says that the section applies *wherever* the corporation has earnings and profits. That is not what Congress said; and if Congress had meant that it could easily have

written it that way. The fact that Congress wrote the provision the way it did shows that it was not intended to apply automatically wherever the corporation has earnings and profits. *Helvering* v. *Griffiths*, 318 U.S. 371.

Another way to put the same argument is to point out that the Government's construction gives no scope whatever for § 112(c)(1). Under the Government's view, § 112(c)(2) would apply in every case. To the extent that there were earnings and profits, the payment would be taxed as a dividend under the first sentence of § 112(c)(2). Any balance of the payment (which would be all of the payment where there were no earnings and profits) would be taxed as a capital gain under the second sentence of § 112(c)(2). *Section 112(c)(1) would never operate at all.*

Both the structure and the history of § 112(c) show that § 112(c)(1) was intended to state the general rule, while § 112(c)(2) was subsequently added to the statute to take care of the special and unusual case where § 112(c) is used as a cloak for what is in substance the distribution of a taxable dividend. But the Government's construction (a) gives no effect to the controlling words which Congress wrote into § 112(c)(2), and (b) leaves no room within which § 112(c)(1) has any effective operation. It would seem that such a construction of the statute would have to be rejected. Both provisions of the section can be given full and harmonious operation if proper weight is given to the "effect" clause in § 112(c)(2).

We turn then to a consideration of the construction of these words which the Government simply eliminates from the statute. Did the payment here have "the effect of the distribution of a taxable dividend"? We submit that it did not. This is a question of statutory construction, a question of law to be decided by the Court. *Security Flour Mills Co.* v. *Commissioner*, 321 U.S. 281; *Claridge Apartments Co.* v. *Commissioner*, 323 U.S. 141, 145. *Cf. Virginian Hotel Corp.* v. *Helvering*, 319 U.S. 523.

Congress specifically declared that one of the "questions of law" which the courts are to consider on review is "the proper interpretation and application of the statute or any regulation having the force of law." House Report No. 1, 69th Cong., 1st Sess. (1925) p. 19; Senate Report No. 52, 69th Cong., 1st Sess. (1926) pp. 36-37.

C. The Analogy to § 115(g)

One of the ways to approach this question is to look for analogies. There is, in fact, a section which contains language, and has a function, very closely analogous to that of § 112(c)(2). This is § 115(g), which applies to cases where a corporation cancels or redeems its stock at such time and in such manner as to be "essentially equivalent to the distribution of a taxable dividend." This language is not the same as that in § 112(c)(2), but it is very similar. There is certainly not much difference between "essentially equivalent to" and "has the effect of."

Thus, the court below properly considered cases arising under § 115(g). It did not confuse § 115(g) with § 112(c)(2). It recognized that § 115(g) was only an analogy; but it concluded properly that § 115(g) furnished a close analogy, and a valuable guide to the proper construction of § 112(c)(2). On this basis, it concluded that the payment made in this case would not have come under § 115(g). There are no controlling decisions of this Court on the proper construction of § 115(g). The construction of § 115(g) which the court below reached was, however, in accordance not only with its own decisions, but also with those of other circuits. *Commissioner* v. *Brown*, 69 F.(2d) 602 (C.C.A. 7th); *Hyman* v. *Helvering*, 63 App. D. C. 221, 71 F.(2d) 342; *Commissioner* v. *Cordingley*, 78 F.(2d) 118 (C.C.A. 1st). Although some of the language in the opinions of the court below may go quite far, there does not seem to be any reason to adopt

the Government's construction of § 115(g), which is, essentially, that all redemptions of preferred stock necessarily come within its scope. Regardless of the applicability of the decisions of the court below to other facts, it would seem sound in holding that the present situation would not have fallen within a proper construction of § 115(g).

D. The "Effect" of the Transaction was that of a Partial Liquidation

Turning again to the language of § 112(c)(2), we may ask: What was the "effect" of the transaction here? Of course, the transaction *was* a recapitalization, and thus a reorganization, but we are now focusing attention upon its "effect."

When § 112(c)(2) refers to a distribution which has "the effect of the distribution of a taxable dividend," we submit that it applies to a distribution which has the effect of an ordinary dividend taxable under § 115(a), and that it does not apply to a distribution of the sort which has the effect of a distribution in partial liquidation to which § 115(c) would apply were it not made as a part of a recapitalization, and thus governed by § 112(c). We submit that the "effect" of the transaction in the present case was that of a partial liquidation and not that of an ordinary or taxable dividend.

1. In the *first* place, it was similar in effect to a liquidating dividend because there was in fact a partial liquidation of the corporation. Its capital was reduced by the transaction, and the reduction of the capital was the basic reason for carrying out the transaction. Each old preferred share, representing $100 par value, was exchanged for 1 1/6th new preferred shares of a par value of $75 per share, and ½ share of $1 par value common stock. (R. 12-13.) Thus each old $100 par value received

new stock with a par value of $88.[11] This was obviously a reduction of the corporation's capital.[12] Each shareholder's stake in the enterprise was reduced. And it was not a *pro forma* reduction. It was a real and necessary reduction designed to remove a surplus deficit from the corporation's books, a necessary step before it could resume the payment of dividends in accordance with the governing state law.

That a liquidating distribution is not an ordinary taxable dividend was held in the leading case of *Hellmich* v. *Hellman*, 276 U.S. 233. It is interesting to note in that case that it was the Government which contended the transaction was taxable as a liquidating rather than as an ordinary dividend, and the Government's argument was sustained. In reaching its result, the Court said (p. 237):

> However, when § 201(a) and § 201(c) [corresponding to § 115(a) and § 115(c) of the 1936 Act] are read together, . . . we think it clear that the general definition of a dividend in § 201(a) was not intended to apply to distributions made to stockholders in the liquidation of a corporation, but that it was intended that such distribution should be governed by § 201(c). . . .

Of particular importance in this connection, is the decision in *Foster* v. *United States*, 303 U.S. 118. In that case, the corporation distributed $1,025,000 in 1929 in liquidation of 500 shares of its own stock. The question at issue was whether this distribution had reduced its earnings and profits so that a subsequent distribution

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11. The petitioner had 3000 old preferred shares of a par value of $100 each (R. 3), or a total par value of $300,000. It received 3500 new preferred shares of a par value of $75 each, and 1500 common shares with a par value of $1 each (R. 3), or a total aggregate par value of new stock of $264,000.

12. The total capitalization of the company was reduced from $2,500,000 to $1,675,000. (R. 14.)

would not be taxable as a dividend. This Court held that the distribution in 1929 was governed by § 115(c) and not by § 115(a), with the result that it was not chargeable against earnings and profits. On the same reasoning, it follows that the distribution here had the effect of a liquidating distribution and not that of a taxable dividend.

Reference may also be made to *Helvering* v. *Credit Alliance Co.*, 316 U.S. 107, where the Court held that a corporation was entitled to a dividends paid credit for a liquidating distribution because of the express provision of § 27(f) of the Revenue Act of 1936, which is applicable in terms only to the computation of the dividends paid credit under that section. Except for that express provision, the Court recognized (p. 110) that "a distribution in *liquidation of earnings* . . . does not constitute a dividend in the proper sense of the term" (italics ours), citing *Hellmich* v. *Hellman*. Since the result reached depended only on § 27(f), and since that provision is limited by its own terms to the computation of the dividends paid credit, it would seem to follow fairly directly that such a distribution is not "a taxable dividend" within other sections of the statute. See also *Commissioner* v. *Kay Mfg. Corp.*, 122 F.(2d) 443, 444-445 (C.C.A. 2d), certiorari denied, 316 U.S. 680.

Other cases which support the same conclusion include *Commissioner* v. *Cordingley*, 78 F.(2d) 118 (C.C.A. 1st); *Kelly* v. *Commissioner*, 97 F.(2d) 915 (C.C.A. 2d); *Hammans* v. *Commissioner*, 121 F.(2d) 4 (C.C.A. 2d); *Amelia H. Cohen Trust* v. *Commissioner*, 121 F.(2d) 689 (C.C.A. 3d); and *Malone* v. *Commissioner*, 128 F.(2d) 967 (C.C.A. 5th). When it is to the Commissioner's advantage to contend that a transaction of this sort is a partial liquidation, he makes that argument, and has been sustained.

In considering the *effect* of the transaction, the definition in § 115(i) of the statute points strongly in the same direction. Section 115(i) reads as follows:

> "*Definition of Partial Liquidation.* — As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

It seems clear that the recapitalization in the present case had much more the effect of a partial liquidation, within the definition given in § 115(i) than it did of an ordinary taxable dividend to which § 115(a) would be applicable. If this is true, then the situation, being a recapitalization, is governed by § 112(c)(1) and not by § 112(c)(2).

The Government undertakes an answer to this point (Br. 49-51) which seems patently unsound. The contention is made that this transaction did not have the effect of a partial liquidation because "it was a complete cancellation of *all* the stock." This argument is completely formal and disregards the substance of the transaction. Under it many partial liquidations would be complete liquidations.[13] The section obviously does not apply where stock is replaced, dollar for dollar, with stock. That is not a "complete cancellation or redemption" of the old stock. But the section does apply where new stock is issued in exchange for old, in connection with a reduction of the capitalization of the company. That is a "complete cancellation or redemption of a part of its

13. If the Government's argument is sound (which we do not believe), then the transaction here was a complete liquidation. That is just as satisfactory to us as a partial liquidation; it does not have the *effect* of a taxable dividend. Of course it was not a complete liquidation; but it had the effect of a partial liquidation because a substantial part of the company's capital was eliminated.

stock," when it is borne in mind that "stock" in this connotation must mean the capital of the company, rather than the specific pieces of paper from time to time representing that capital.

If the Tax Court is to be regarded as the guardian of this part of the law, the course of its decisions would seem to be inconsistent with the result reached by the single judge in the present case. In *Holmby Corp.*, 28 B.T.A. 1092, the Board was concerned with a distribution made by a corporation which had earnings and profits, and which the taxpayer contended was an ordinary dividend (not taxable to a corporation). The Board held, however, that the distribution was "in partial liquidation", saying (p. 1102):

> A distribution may come within the broad definition of a "dividend" as defined in section 201(a) [§ 115(a)] *supra*, and yet at the same time be the very transaction specifically provided for in section 201(c) [§ 115(c), relating to partial liquidation] of the statute. *Langstaff* v. *Lucas*, 9 Fed.(2d) 691; affd., 13 Fed.(2d) 1022; *Hellmich* v. *Hellman*, 276 U. S. 233.

This was a decision of the full Board, without dissent. It was affirmed on appeal *Holmby Corp.* v. *Commissioner*, 83 F.(2d) 548 (C.C.A. 9th). The Appellate Court said (p. 549): "The fact that the distributions were called 'dividends' and were made, in part, from earnings and profits, and that some of them were made before liquidation or dissolution proceedings were commenced, is not controlling."

In *Tecla M. Straub*, 29 B.T.A. 216, 220, the Board declared:

> The evidence, in our opinion, establishes that the distribution of 1928 was made in partial liquidation of the corporation's capital stock. This is true notwithstanding the fact that the method was that of reducing the face value of each outstanding share

and not that of reducing the number of outstanding shares.

This decision was affirmed on appeal, and the above language was quoted with approval by the court. *Commissioner* v. *Straub*, 76 F.(2d) 388 (C.C.A. 3d).

The Board also found that there was a partial liquidation in *Benjamin R. Britt*, 40 B.T.A. 790. Much of its language is so closely applicable to the present case that it seems advisable to set it out here. It said (pp. 796-797):

> To be a partial liquidation it is not necessary that the corporation be planning a cessation of business or be in the process of final liquidation or that all of the preferred stock be retired at once. *Commissioner* v. *Quackenbos*, 78 Fed.(2d) 156; *Commissioner* v. *Cordingley*, 78 Fed.(2d) 118. In *Salt Lake Hardware Co.*, 27 B.T.A. 482, holding that amounts paid to redeem outstanding preferred stock constituted amounts distributed in partial liquidation, the Board said: "As set forth in the statute, section 201, *supra*, [the counterpart of section 115(i) in the 1934 Act] a partial liquidation takes place whenever a corporation distributes money or assets in complete cancellation or redemption of a part of its capital stock. No particular portion is mentioned, nor is the word 'part' in any way limited. Whether the amount so redeemed be all of a series or class, or only a part thereof, apparently makes no difference under the definition adopted by Congress." See also *Dill Manufacturing Co.*, 39 B.T.A. 1023.

Petitioner further contends that United Carbon Co. redeemed this stock out of profits, rather than capital, and that section 115 of the 1934 Act deals only with distributions which effect a change in the capital structure of the corporation. Implicit in this is the view that a distribution of profits can not be a partial

liquidation. The decision of the Supreme Court in *Helvering* v. *Chester N. Weaver Co.*, 305 U.S. 293, concludes the petitioner in that position. This cancellation of this stock did reduce its capital. When United Carbon Co. reacquired its stock, it canceled it, and could not reissue the shares acquired.

The decision in this case was affirmed on appeal, but on other grounds, without reference to the partial liquidation point. *Britt* v. *Commissioner*, 114 F.(2d) 10 (C.C.A. 4th).

Finally, reference should be made to the recent decision of the Tax Court in *Hamilton Allport*, 4 T.C. 401. The decision there, by Judge Sternhagen, contains the following clear statement (p. 403):

> This requirement had nothing to do with any plan which the corporation might have for an expansion or nonliquidation of its business. The statute applies, not to a distribution in liquidation of the corporation or its *business*, but to a distribution in cancellation or redemption of a part of its *stock*. (Italics in original.)

All of these decisions, we submit, are inconsistent with the Government's position in the present case.

None of the many cases cited by the Government on the construction of § 112(c)(2) involved a situation where the capital of the corporation was reduced as a part of the transaction. That is the essential element in this case, the factor which (a) distinguishes it from cases on which the Government relies, and (b) shows that the transaction did not have the *effect* of the distribution of a taxable dividend, but was more nearly akin to a distribution in partial liquidation.

The failure to recognize the fact that the cash paid here was paid in connection with the reduction of the corporation's capital runs through the Commissioner's whole

brief. When that fact is taken into account the Commissioner's argument and authorities become inapplicable. The "effect" of a cash payment in connection with a reorganization depends upon the nature and circumstances of the particular reorganization. Where a company sells out its tangible assets to another company in connection with a reorganization, and distributes its cash to its shareholders, the cash distribution may well have the effect of the distribution of a taxable dividend, as many of the Commissioner's cases show. But that is not what was done here. Here there was no selling out with an accompanying distribution of surplus. Instead there was a reduction of the corporation's capital. A payment made in connection with such a transaction "has the effect of" a partial liquidation rather than the distribution of an ordinary dividend, and thus is not within the language or the purpose of § 112(c)(2).

2. This leads to the *second* reason why the effect of the transaction was that of a liquidating dividend rather than that of an ordinary or taxable dividend. This is because the corporation could not legally declare an ordinary dividend at the time the transaction was carried out. It makes no difference that *if* the corporation could have declared a dividend it would have been taxable under § 115(a) since it had earnings and profits of the current year. The important fact is that the corporation could not declare a dividend under state law because its books showed a deficit in surplus. For this reason the corporation had in fact paid no dividends for more than five years before the transaction in question (R. 11-12). It is true that the Federal Revenue Act establishes a Federal test of when a dividend actually made by a corporation is taxable. But the Federal law does not establish a test which controls the question whether a corporation can declare a dividend. That is peculiarly a matter within the control of state law, to which the Federal law could hardly be applied, and as to which Congress has not

sought to make any provision. Since, in the present case, the corporation *could* not declare a taxable dividend, it is difficult to see how the transaction carried out could have the effect of what it could not do.

In the setting of the case, it is perfectly clear that the court below did not decide that the transaction *was* a partial liquidation. The question before the court was the *effect* of the distribution, and what it said in its opinion was obviously directed to that question.

The Government, however, misses the point, and includes in its brief (Br. 54-56) an argument that if the transaction *was* a partial liquidation, the amount received would be taxable in full. That is doubtless true. But no one has ever argued or suggested that the transaction *was* a liquidation. On the contrary, it has from the beginning been agreed by the parties that the transaction which was carried out was a recapitalization of the company, and that therefore the exchange which was made was in connection with a reorganization, and its tax consequences are governed by § 112(c) of the statute. All that we argue, and all that the court below put into its opinion, is designed to meet the contention of the Commissioner that the transaction had the *effect* of a taxable dividend. Our argument, therefore, is directed to the question of effect, and not to what the transaction was. There is no dispute on the latter question. But on the plane of effect, we argue, for the reasons given, that the effect of the transaction, if it had any other effect than that of the straightforward recapitalization it purported to be, was rather that of a distribution in partial liquidation than that of an ordinary taxable dividend. And if its effect is found to be that of a recapitalization, or of a distribution in partial liquidation, or anything else than an ordinary taxable dividend, then § 112(c)(2) has no application to the present case.

E. The Committee Reports and Regulations Show the Inapplicability of § 112(c)(2)

Resort to the legislative history of § 112(c)(2) supports the same conclusion. It shows that § 112(c)(2) was designed to apply to transactions which amounted in substance to devices for the distribution of an ordinary dividend with no other legitimate purpose or effect. The provision now found in § 112(c)(2) first made its appearance as § 203(d)(2) of the Revenue Act of 1924, and it has remained without change since that time. The purpose of that provision was explained in substantially identical language in the Committee Reports. (House Report No. 179, 68th Congress, 1st Session, pp. 14-15, reprinted in 1939-1 Cum. Bull. Part 2, pp. 241, 252; Senate Report No. 398, 68th Congress, 1st Session, pp. 15-16, reprinted in 1939-1 Cum. Bull. Part 2, pp. 266, 277.) This passage reads as follows:

> (2) There is no provision of the existing law which corresponds to paragraph (2) of subdivision (d). This paragraph provides that any amount distributed by a corporation in connection with a reorganization which has the effect of a taxable dividend shall be taxed as a dividend.
>
> The necessity for this provision may best be shown by an example: Corporation A has capital stock of $100,000, and earnings and profits accumulated since March 1, 1913, of $50,000. If it distributes the $50,000 as a dividend to its stockholders, the amount distributed will be taxed at the full surtax rates.
>
> On the other hand, corporation A may organize corporation B, to which it transfers all its assets, the consideration for the transfer being the issuance by B of all of its stock and $50,000 in cash to the stockholders of corporation A in exchange for their stock in corporation A. Under the existing law, the $50,000

distributed with the stock of corporation B would be taxed, not as a dividend, but as a capital gain, subject only to the 12½ per cent rate. The effect of such a distribution is obviously the same as if the corporation had declared out as a dividend its $50,000 earnings and profits. If dividends are to be subject to the full surtax rates, then an amount so distributed should also be subject to the surtax rates and not to the 12½ per cent rate on capital gain.

This statement shows that the situation to which Congress directed § 112(c)(2) was essentially different from that presented in the present case. The example given is that of a corporation with surplus available for distribution as a dividend, and with no restriction on its power to declare those earnings as a taxable dividend. Instead of making such a declaration, however, it goes through the form of a reorganization, similar to that struck down in *Gregory* v. *Helvering*, 293 U.S. 465, the sole purpose and effect of which is to distribute the earnings and profits to the shareholders without altering their capital investment in the company. In the present case, however, the company was legally disabled from declaring a taxable dividend. The transaction which it carried out was no sham. It was obviously designed for a bona fide business purpose, so that the corporation might reestablish its credit and put itself into condition so that it might declare dividends. No contention has even been made to the contrary. Moreover, the transaction here involved an actual reduction in the capitalization of the company. The stake of each preferred stockholder in the venture was reduced while in the situation mentioned in the Committee Report the capital investment of the shareholder remained unchanged.

Similarly, the only provision in the Regulations which bears on § 112(c)(2) shows that it has no application to the present case. This is found in Art. 112(g)-4 of

Regulations 94, issued under the Revenue Act of 1936.[14] It merely repeats the language of the statute, and then sets out the same example as that given in the Committee Report, thus showing the Commissioner's understanding that § 112(c)(2) applies only to essentially sham transactions, where the stockholders' capital investment in the enterprise remains unchanged. This Regulation continues in effect to the present time without change. See § 29.112(c)-4 of Regulations 111.

Thus the legislative history and the Regulations show that § 112(c)(2) was designed to reach a different sort of transaction than that involved here, and particularly that it was not intended to apply to transactions which have the effect of liquidating dividends rather than of ordinary taxable dividends.

F. The Government's Position Leads to Incongruities

The fact that the taxpayer here received cash in connection with the transaction does not mean that he received

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14. The full text of the applicable passage reads as follows:

> If the distribution of such other property or money by or on behalf of a corporation in the course of a reorganization has the effect of the distribution of a taxable dividend, then, as provided in section 112(c)(2), there shall be taxed to such distributee (1) as a dividend, such an amount of the gain recognized on the exchange as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and (2) the remainder of the gain so recognized shall be taxed as a gain from the exchange of property.
>
> *Example:* The X Corporation has a capital of $100,000 and earnings and profits of $50,000 accumulated since February 28, 1913. The X Corporation in 1936 transfers all of its assets to the Y Corporation in exchange for the issuance of all of the stock of the Y Corporation and the payment of $50,000 in cash to the stockholders of the X Corporation. A, who owns one share of stock in the X Corporation, for which he in 1928 paid $100, receives a share of stock in the Y Corporation worth $100 and the sum of $50 in cash in addition. A is liable to both the normal tax and the surtax on $50.

taxable income. It is the normal thing to receive cash in connection with a capital transaction. If a person owns shares and sells them, he receives cash, and has a capital gain or loss. Section 112(b)(3) of the statute provides for the non-recognition of *gain or loss* on an *exchange* of stock in connection with a reorganization. The basic transaction is an *exchange*. It is a typical capital transaction. It is just what happened here. The present taxpayer gave up securities, and received in exchange therefor, other securities and cash. Thus, if there were no special statutes affecting the situation, there would clearly have been a capital gain on an *exchange*. See *Cullinan* v. *Walker*, 262 U.S. 134; *Marr* v. *United States*, 268 U.S. 536. But Congress has intervened in this situation and provided that no gain or loss shall be recognized on such an exchange in connection with a reorganization (§ 112(b)(3)), with the further qualification that if cash is received on the exchange, then the gain shall be recognized, but only to the amount of the cash received. Section 112(c)(1). But the gain so recognized still remains *capital gain* realized on an *exchange*. This is the basic normal situation. Section 112(c)(2) then provides that if the cash received had "the effect of the distribution of a taxable dividend" it shall be taxed as a dividend. But it by no means follows, as the Government has argued, that all cash received in connection with a reorganization has the effect of a dividend. Throughout its brief, the Government constantly overlooks the essentially capital nature of the transaction which was carried out here. By common consent, it was a *recapitalization*.

In the present case, the taxpayer had a gain on the exchange. Let us consider, however, the case of a shareholder who had a *loss* on such an exchange as that involved here, that is, one whose cost basis was higher than the amount of securities and cash which he received in the exchange. Such a taxpayer would receive cash to the same extent as the taxpayer here. Yet it is clear that the cash received would not be taxable to him as a dividend.

Thus, the Government's argument here leads to the incongruous result that some stockholders would receive a dividend and some would not, on the very same transaction, depending not on what was done, but on what their cost basis happened to be.

The real difficulty with this position stands out when it is considered from the point of view of the corporation. If the transaction is a dividend here, it must involve a distribution of earnings and profits. Yet there would be the same distribution of earnings and profits in the case of a stockholder who had a loss; but in such a case there clearly would be no dividend. Thus the Government's argument involves the conclusion that there can be a distribution of earnings and profits which is not a dividend. It seems doubtful whether the Government would accept that position directly, despite the statement in its Brief (p. 48).

The Government suggests this difficulty in the last paragraph of its brief (Br. 60), but does not directly face it. It points up, however, a basic incongruity in the Government's position, which can be avoided by recognizing that the transaction here involved was a capital transaction, having the effect of a partial liquidation, and not involving either the paying out of earnings and profits by the corporation or their receipt by the taxpayer. *Cf. Bass* v. *Commissioner*, 129 F.(2d) 300 (C.C.A. 1st).

CONCLUSION

This Court does not have jurisdiction of the petition. If it does, the judgment below is correct and should be affirmed.

Respectfully submitted,

ERWIN N. GRISWOLD,
HOLT S. McKINNEY,
Counsel for Respondent.

March, 1945.

APPENDIX

Certificate of Clerk of Circuit Court of Appeals

UNITED STATES CIRCUIT COURT OF APPEALS

SECOND CIRCUIT

ESTATE OF EDWARD T. BEDFORD,
Title Guarantee & Trust Company, Executor,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

I, ALEXANDER M. BELL, Clerk of the United States Circuit Court of Appeals, for the Second Circuit, do hereby certify that the docket entries in the above entitled case in this Court are as follows:

August	19, 1943	Filed Record
August	31, 1943	Filed order extending time
October	7, 1943	Filed 24 copies, record
October	7, 1943	Filed brief, petitioner
October	22, 1943	Filed appearance, Comnr by J. P. Wenschek, et al.
December	15, 1943	Filed appearance, Comnr by S. O. Clark, Jr., et al.
December	15, 1943	Filed brief, respondent.
January	3, 1944	Filed brief, petitioner, reply
August	8, 1944	Order reversed, A. N. Hand, *C. J.*
August	29, 1944	Filed order for mandate
August	29, 1944	Issued mandate
October	13, 1944	Certified record to Sol Gen'l
December	2, 1944	Filed notice.

Dated, New York, December 8, 1944.

ALEXANDER M. BELL,
Clerk, United States Circuit Court
of Appeals.

[Seal]

SUPREME COURT OF THE UNITED STATES.

No. 710.—October Term, 1944.

Commissioner of Internal Revenue, Petitioner, *vs.* Estate of Edward T. Bedford, Title Guarantee and Trust Company, Executor.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[May 21, 1945.]

Mr. Justice Frankfurter delivered the opinion of the Court.

At the threshold, the jurisdiction of the Court is challenged on the ground that the petition for the writ of certiorari was not filed within three months after "entry" of the "judgment" below as required by the Judiciary Act of February 13, 1925.[1]

The steps by which the case came here are these. On August 8, 1944, the Circuit Court of Appeals for the Second Circuit filed a document entitled "Opinion"; on the same day the Clerk made a docket entry reading, "Order reversed, A. N. Hand, *C.J.*"; on August 29, 1944, a document entitled "Order for Mandate" was filed, and the mandate issued that day; on November 29, 1944, the petition for writ of certiorari was filed. The petition was filed too late if the "Opinion", as respondent contends, constitutes the "judgment". It was filed in time, if the "Order for Mandate" may properly be deemed the "judgment". The issue was ably pressed before us, and, since it concerns our power to review cases coming from what is perhaps the busiest circuit, it calls for more than summary treatment.

Even long continued practice cannot alter the limits within which Congress has bound the appellate judisdiction of this Court. See *Dept. of Banking* v. *Pink*, 317 U. S. 264. But such prac-

[1] "Sec. 8(a) That no writ of error, appeal, or writ of certiorari, intended to bring any judgment or decree before the Supreme Court for review shall be allowed or entertained unless application therefor be duly made within three months after the entry of such judgment or decree, excepting that writs of certiorari to the Supreme Court of the Philippine Islands may be granted where application therefor is made within six months: *Provided*, That for good cause shown either of such periods for a writ of certiorari may be extended not exceeding sixty days by a justice of the Supreme Court." 43 Stat. 936, 940, 28 U. S. C. § 350.

tice may be decisive in interpreting procedural ways which, as a matter of dialectic or abstract analysis, may appear dubious. We are naturally impressed by the common understanding that in the Circuit Court of Appeals for the Second Circuit the so-called "Order for Mandate" is deemed the judgment. Robertson and Kirkham, Jurisdiction of the Supreme Court of the United States (1936) § 384. We have taken and decided as a matter of course a considerable number of cases in which certiorari was sought within three months after entry of the "Order for Mandate" but not within three months after the "Opinion".[2] This practical understanding of the controlling significance, for appellate purposes, of the "Order for Mandate" is supported and certainly not contradicted by all that is conveyed by the "Opinion" and "Order for Mandate" and the Rules of the lower court.

It does not detract from the "Opinion" as an opinion that in its heading it gives as dates "Argued January 6, 1944
Decided August 8, 1944", and that it concludes with "The order of the Tax Court is reversed." The same or similar phrases are commonly employed in opinions of this Court without changing their character as opinions. Nor do like phrases in the opinions of the other circuit courts of appeals turn them into judgments, since in all other circuits judgment orders are separately filed. In spite of its title, the "Order for Mandate" on its face fulfills the function of such a judgment order. It recites that

"it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell,
Clerk.

By A. Daniel Fusaro,
Deputy Clerk."

This language plainly imports that this is the judgment and that it is then being rendered. Nor does the fact that the order was

[2] During the 1941, 1942 and 1943 Terms, this Court entertained reviews and affirmed judgments of the Circuit Court of Appeals for the Second Circuit in not less than ten such cases: Commercial Corp. *v.* N. Y. Barge Corp., 314 U. S. 104; New York *v.* United States, 315 U. S. 510; Mother Lode Co. *v.* Comm'r, 317 U. S. 222; Smith *v.* Shaughnessy, 318 U. S. 176; Helvering *v.* Griffiths, 318 U. S. 371; Emil *v.* Hanley, 318 U. S. 515; Fisher Co. *v.* Witmark & Sons, 318 U. S. 643; Equitable Society *v.* Comm'r, 321 U. S. 560; Medo Corp. *v.* Labor Board, 321 U. S. 678; United States *ex rel.* Irensilber *v.* Bausch & Lomb Optical Co., 320 U. S. 711 (equally divided court).

prepared by the clerk and bears his signature detract from its quality as a judgment. A judgment "is the act of the court", *Ex parte Morgan*, 114 U. S. 174, 175, even though a clerk does all of the ministerial acts, as here, in conformity with his court's standing instructions.

The Rules of the court below governing opinions, rehearings, issuance of mandate and stay of mandate are invoked to show that the "Opinion" is the appealable "judgment". These Rules, like other rules, are not phrased with such fastidious precision as to make of all the parts a perfect harmony. But while substantial debating points may be taken,[3] nothing in these Rules contradicts the natural meaning yielded by the terms of the "Opinion" and the "Order of Mandate", as reflected in the practice of the Second Circuit and in our own, which treats not the "Opinion" but the "Order for Mandate" as the order of judgment. The Rules would have to be far less artistic than they are to warrant us in holding that the Circuit Court of Appeals has consistently misinterpreted some of its own Rules. Whether the announcement of an opinion and its entry in the docket amounts to a judgment for purposes of appeal or whether that must await some later formal act, ought not to be decided on nice-spun argumentation in disregard of the judicial habits of the court whose judgment is called into question, of the bar practising before it, of the clerk who embodies its procedural traditions, as well as in conflict with the assumption of the reviewing court.

But now that the existing practice has revealed abstract disharmonies, if not difficulties, the Circuit Court of Appeals will doubtless establish a more tidy system for meeting the technical requirements for review here. The normal time for entering a

[3] Respondent argues that the Rules of the court below, with respect to the opinions of the court, rehearings, issuance of mandate, and stay of mandate, show that the "opinion" is meant to constitute the court's judgment. But these Rules compute time, with respect to filing of petitions for rehearing and for issuance of mandate, not from entry of a "judgment" but from the "filing of the opinion of this court". Some difficulty is raised because Rule 27 refuses a rehearing "unless a judge who concurred in the judgment desires it." Also respondent finds it paradoxical to "stay" the court's mandate under Rule 30 when the mandate is customarily issued on the same day the "Order for Mandate" is filed. And respondent argues that the court could not have meant to confer upon its clerk discretion to hold up, for varying lengths of time, the rendering of a judgment until fees have been paid by the prevailing party. In this case the "Order for Mandate" and issuance of the mandate were delayed for twenty-one days, and were not entered within fifteen days from the filing of the opinion which Rule 30 requires; the time has been variously extended in other cases.

and the court's instructions

judgment, as the starting point for determining whether review will be sought or whether there has been acquiesence in a judgment, should be fixed. The uncertainties inherent in litigation should not be needlessly prolonged. The entry of the "Order for Mandate", which in the Second Circuit begins the running of the period for appeal, is apparently variable and vagrant. In these days of rapid communication, the statutory allowance of three months is more than ample for an unsuccessful litigant to determine whether to seek further review. So long a period ought not to be extended by delay in entering a judgment nor should the burden of securing such entry be put upon the successful litigant. There are bound to be diversities in the modes of rendering and recording judgments of the forty-eight systems of State courts. Uniformity in the entry of judgment among the eleven circuits forming the single federal judicature ought to be capable of achievement without loss to the geographic flexibility of the system.

This brings us to the merits, which involve the validity of an income tax deficiency assessment for 1937. The case is this. The estate of Edward T. Bedford, who died May 21, 1931, included 3,000 shares of cumulative preferred stock (par value $100) of Abercrombie & Fitch Company. Pursuant to a plan of recapitalization respondent, as executor of the estate, in 1937 exchanged those shares for 3,500 shares of cumulative preferred stock (par value $75), 1,500 shares of common stock (par value $1), and $45,240 in cash (on the basis of $15.08 for each of the old preferred shares). The recapitalization had been proposed because the company, after charging against its surplus account stock dividends totaling $844,100, distributed in 1920, 1928, and 1930, had incurred a book deficit in that account of $399,771.87. Because of this deficit, the company, under applicable State law, was unable to pay dividends although for the fiscal year ending January 31, 1937 it had net earnings of $309,073.70.

By comparing the fair market value of the old preferred shares at the date of Bedford's death with the market value of the new stock and cash received the gain to his estate was $139,740. Admittedly the recapitalization was a reorganization, § 112 (g) (1) (D) of the Revenue Act of 1936, 49 Stat. 1648, 1681, 26 U. S. C. § 112(g) (1) (E), so that only the cash received, but none of the stock, is taxable. Sections 112(b) (3), 112(c) (1), 49 Stat. 1648.

1679, 1680, 26 U. S. C. §§ 112(b)(3), 112 (c)(1). The sole issue is whether the cash, $45,240, is taxable as a dividend, or merely as a capital gain to the extent of 40%. The Tax Court sustained the determination of the Commissioner that the cash was taxable as a dividend, 1 T. C. 478, but was reversed by the Circuit Court of Appeals. 144 F. 2d 272. On a showing of importance to the administration of the Revenue Acts, we granted certiorari. — U. S. —.

The precise question is whether the distribution of cash in this recapitalization "has the effect of the distribution of a taxable dividend" under § 112(c)(2) of the Revenue Act of 1936 and as such is fully taxable, or is taxable only at the rate of 40% as a capital gain under § 112(c)(1) of that Act. The relevant provisions read: "(c) *Gain from Exchanges not Solely in Kind.*— (1) If an exchange would be within the provisions of subsection (b), (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property. (2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his rateable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property."

The history of this legislation is not illuminating. Section 112(c)(2) originated in § 203(d)(2) of the Revenue Act of 1924, 43 Stat. 253, 257. But the reports of the Congressional Committees merely use the language of the section to explain it. H. Rep. No. 179, 68th Cong., 1st Sess., pp. 14-15; S. Rep. No. 398, 68th Cong., 1st Sess., pp. 15-16. Nor does the applicable Treasury Regulation add anything; it repeats substantially the Committee Reports. Treas. Reg. 94, Art. 112 (g)-4. We are thrown back upon

the legislative language for ascertaining the meaning which will best accord with the aims of the language, the practical administration of the law and relevant judicial construction.

Although Abercrombie & Fitch showed a book deficit in the surplus account because the earlier stock dividends had been charged against it, the parties agree that for corporate tax purposes at least earnings and profits exceeding the distributed cash had been earned at the time of the recapitalization. That cash therefore came out of earnings and profits and such a distribution would normally be considered a taxable dividend, see § 115(a),[4] and has so been treated by the courts in seemingly similar situations. It has been ruled in a series of cases that where the stock of one corporation was exchanged for the stock of another and cash and then distributed, such distributions out of earnings and profits had the effect of a distribution of a taxable dividend under § 112(c)(2). *Comm'r* v. *Owens*, 69 F. 2d 597; *Comm'r* v. *Forhan Realty Corp.*, 75 F. 2d 268; *Rose* v. *Little Inv. Co.*, 86 F. 2d 50; *Love* v. *Comm'r*, 113 F. 2d 236; *Campbell* v. *United States*, 144 F. 2d 177. The Tax Court has reached the same result, that is, has treated the distribution as a taxable dividend, in the case of the recapitalization of a single corporation. *McCord* v. *Comm'r*, 31 B. T. A. 342, 344; *J. Weingarten, Inc.* v. *Comm'r*, 44 B. T. A. 798, 808-809; *Knapp Monarch Co.* v. *Comm'r*, 1 T. C. 59, 69-70, affirmed on other grounds, 139 F. 2d 863. We cannot distinguish the two situations and find no implication in the statute restricting § 112(c)(2) to taxation as a dividend only in the case of an exchange of stock and assets of two corporations.

Respondent, however, claims that this distribution more nearly has the effect of a "partial liquidation" as defined in § 115(i).[5]

[4] "(a). *Definition of Dividend.*—The term 'dividend' when used in this title (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made."

[5] "(i). *Definition of Partial Liquidation.*—As used in this section the term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

But the classifications of § 115, which governs "Distributions of Corporations" apart from reorganizations, were adopted for another purpose. They do not apply to a situation arising within § 112. The definition of a "partial liquidation" in § 115(i) is specifically limited to use in § 115. To attempt to carry it over to § 112 would distort its purpose. That limitation is not true of § 115(a) which defines "dividend" for the purpose of the whole title. Accordingly, this definition is infused into § 112(c)(2). Under § 115(a) a distribution out of accumulated earnings and profits is a "dividend", thus confirming the conclusion that a distribution of earnings and profits has the "effect of the distribution of a taxable dividend" under § 112(c)(2).

Recapitalization does not alter the "effect". Although the capital of a company is reduced, the cash received is a distribution of earnings and profits and as such falls within the federal tax. That the company's treatment of its stock dividends may bring consequences under State law requiring a capital reduction does not alter the character of the transactions which bring them within the federal income tax. Recapitalization is one of the forms of reorganization under § 112(g)(1)(D). It cannot therefore be urged as a reason for taking the transaction out of the requirements of § 112 and forcing it into the mold of § 115. The reduction of capital brings § 112 into operation and does not give immunity from the requirements of § 112(c)(2).

Treating the matter as a problem of statutory construction for our independent judgment, we hold that a distribution, pursuant to a reorganization, of earnings and profits "has the effect of a distribution of a taxable dividend" within § 112(c)(2). As is true of other teasing questions of construction raised by technical provisions of Revenue Acts the matter is not wholly free from doubt. But these doubts would have to be stronger than they are to displace the informed views of the Tax Court. And if the case can be reduced to its own particular circumstances rather than turn on a generalizing principle we should feel bound to apply *Dobson* v. *Commissioner*, 320 U. S. 489, and sustain the Tax Court.

Reversed.